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FOOD INVENTORIES

Inventory Management of Federally Owned and Donated Surplus Foods

GAO/RCED-86-11

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United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-219014

December 5, 1985

The Honorable Thad Cochran
Chairman, Subcommittee on Agriculture,
Rural Development, and Related
Agencies,
Committee on Appropriations
United States Senate

The Honorable Thomas F. Eagleton
The Honorable John Heinz
United States Senate

The Honorable William F. Clinger, Jr.
The Honorable William H. Gray, III
The Honorable Mary Rose Oakar
House of Representatives

Pursuant to your requests, this report discusses the problems we found regarding the management of food inventories for the Temporary Emergency Food Assistance Program. While recognizing the corrective actions taken by the Food and Nutrition Service and the four states reviewed, the report contains recommendations directed at improving the Service's monitoring of the states' inventory management systems.

We are sending copies of the report to the Director, Office of Management and Budget, and the Secretary of Agriculture.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

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Executive Summary

As a result of its dairy price-support purchases, the U.S. Department of Agriculture's (USDA's) inventory of dairy products grew from $570 million in September 1979 to $4.1 billion in September 1984. As of August 1985, the inventory was valued at $3.1 billion. Responding to a congressional mandate to reduce the inventory, USDA initiated a special distribution program in December 1981 under which it has provided the states with over $2 billion worth of dairy products and other foods for distribution to the needy. (See p. 8.)

In response to several congressional requests, GAO reviewed USDA's and four states' inventory management systems to determine whether (1) the systems assured that products owned by USDA and special distribution program products provided to the states were properly controlled and (2) USDA minimized transportation and storage costs.

Background

To support the price of milk, USDA purchases, at designated prices, all butter, cheese, and nonfat dry milk that processors offer it that meet USDA specifications. The products are stored in public warehouses until sold or donated under one of USDA's domestic and foreign donation programs. (See pp. 8-10.)

The special distribution program, a supplement to USDA's permanent nutrition programs, was formalized by legislation in March 1983 and named the Temporary Emergency Food Assistance Program. The program, recently extended through March 1986, is administered nationally by USDA's Food and Nutrition Service, at the state level by designated state distributing agencies, and locally by local government and charitable agencies. Volunteers generally distribute the foods to the needy. The Service requires state and local agencies to maintain complete and accurate records on the receipt, disposal, and inventory of surplus products and to provide it with monthly inventory reports. (See pp. 10-12.)

GAO reviewed USDA's written inventory management procedures, compared USDA's perpetual inventory records with those kept by a randomly selected sample of 88 warehouses, visited 6 warehouses, and reviewed USDA examination records for all 470 warehouses examined by USDA in 1984. GAO also reviewed the inventory management procedures of four states (California, Michigan, New York, and Pennsylvania) and tested inventory records at selected state warehouses. (See pp. 12-16.)

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Results in Brief

GAO found that USDA's system properly accounts for the receipt, disposal, and inventory of dairy products and assures that stored products are properly cared for. Also, USDA efficiently managed the storage and transportation costs of these products in those instances GAO examined.

Due primarily to the special assistance program's temporary nature, however, the Service and the four states GAO reviewed generally did not ensure that state and local inventory systems were implemented as designed. At the time of GAO's review, the states had taken or were taking actions to improve their inventory management practices. The Service, however, still needs to improve its oversight of the states' programs.

Principal Findings

USDA's Inventory Management Systems

USDA maintains a computerized perpetual inventory record of dairy products stored in each warehouse, periodically reconciles its book inventory with physical inventories, and has procedures to account for the products shipped in and out of the warehouses. USDA also inspects the warehouses and products periodically to ensure that the products are properly cared for.

GAO determined that (1) USDA's perpetual inventory records agreed with those maintained by all 88 warehouses GAO sampled, (2) examinations made by USDA personnel at 6 warehouses GAO visited conformed to USDA's procedures, and (3) nearly all of the 470 warehouses USDA used in 1984 were examined by USDA personnel twice a year as required. (See pp. 18-24.)

GAO found that USDA generally shipped products to and from the closest locations and used warehouses charging lower storage rates. For example, GAO found that cheese products used to fill 119 state orders in June 1984 were shipped from warehouses reasonably close to destination points and that USDA reduced its inventories in eight of nine warehouses charging above-average rates. (See pp. 24-32.)

State Inventory Management Systems

The inventory management systems the four states used did not always ensure that products donated for the emergency food assistance program were properly accounted for and managed. For example:

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- California was not properly implementing its procedures designed to ensure that all products it ordered from the Service were received—it had receipt documentation for only 22 percent of 293 orders GAO reviewed.
- Pennsylvania was not properly carrying out its requirements to maintain accurate records and take physical inventories.
- New York, contrary to good inventory management practices, did not require local agencies to prepare or submit periodic reports accounting for the receipt, disposal, and inventory of products.
- Michigan required monthly inventory reports of local agencies but, at the time of GAO's review, had not received reports from about half those agencies.

These states have initiated actions that, if properly implemented, should improve inventory control practices at both the state and local levels. (See pp 34-56.)

USDA Monitoring of State Programs

For other USDA food assistance programs, such as the school lunch program, the Service requires on-site periodic evaluations of the states' inventory control practices. For the emergency food assistance program, however, the Service does not require its regional offices to periodically evaluate the state programs. As a result, one of the four regional offices GAO visited (there are seven) made no evaluations of state systems. Although the other three offices made evaluations that were generally comprehensive in their coverage of state efforts, GAO found that the resulting reports did not present enough information for management to judge whether the states' systems were adequate. For example, GAO reviewed one report that provided the evaluator's conclusions but no information on how the conclusions were reached.

Further, although the states were required to submit monthly inventory reports, only one of the regional offices reviewed them. A primary purpose for requiring the reports is to ensure that states' inventory levels are not excessive. The regional offices were not reviewing the reports because, among other reasons, some states did not report inventory data on the emergency food assistance program separately. (See pp. 57-63.)

Recommendations

GAO recommends that the Service require its regional offices to periodically evaluate the states' inventory management systems. Reports on

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such evaluations should provide management with sufficient information to determine whether state and local agencies are properly implementing their systems. GAO is also recommending action to improve the Service's monitoring of state inventory levels. (See p. 66.)

Agency and State Comments

USDA generally agreed with GAO's recommendations. USDA said, however, that while it and GAO reached the same basic conclusions, GAO's draft report failed to acknowledge the developmental nature of the program. (See pp. 66-67.) Three of the four states generally agreed with GAO's findings on their programs; one, Pennsylvania, said that some findings did not apply to current conditions. GAO added updated information where appropriate. (See apps. II-VI.)

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Abbreviations

AMS	Agricultural Marketing Service
ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
CED	Community and Economic Development Division (GAO)
FNS	Food and Nutrition Service
GAO	General Accounting Office
KCCO	Kansas City Commodity Office
OIG	Office of the Inspector General
RCED	Resources, Community, and Economic Development Division (GAO)
TEFAP	Temporary Emergency Food Assistance Program
USDA	U.S. Department of Agriculture

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Introduction

The U.S. Department of Agriculture's (USDA's) dairy price-support program is designed, in part, to assure an adequate milk supply. Under the program, USDA purchases surplus dairy products—butter, cheese, and nonfat dry milk—that it then stores in public warehouses until the products are (1) distributed under one of USDA's domestic and foreign commodity donation programs, (2) sold, or (3) bartered. In recent years, however, milk production has exceeded demand to such an extent that USDA has purchased and accumulated large quantities of dairy products.

From fiscal year 1979 through fiscal year 1984, USDA purchased about $10.5 billion of surplus dairy products and, at the end of fiscal year 1984, had dairy products in inventory valued at about $4.1 billion. As of August 31, 1985, the inventory was valued at $3.1 billion. Also, the government has spent hundreds of millions of dollars storing, handling, transporting, and managing these products.

In response to a congressional directive to reduce the dairy inventory, USDA began making dairy products available to states for distribution to the needy in December 1981. The Congress formalized this effort as the Temporary Emergency Food Assistance Program (TEFAP) in March 1983. Under this program, administered by USDA's Food and Nutrition Service (FNS) and its seven regional offices, the states received about 1.8 billion pounds of surplus products, primarily cheese, butter, and nonfat dry milk, valued at about $2.3 billion through November 1984. In addition, up to $50 million a year has been available to reimburse state and local agencies for storage and transportation costs incurred under the program.

USDA Dairy Price-Support Program

The dairy price-support program, created by the Agricultural Act of 1949 (7 U.S.C. 1421-1449), is designed in part to help assure dairy farmers a minimum average price for manufacturing grade milk and to assure an adequate milk supply for the nation. Under the program, USDA's Commodity Credit Corporation (CCC), a wholly owned government corporation, purchases surplus butter, cheese, and nonfat dry milk products at designated prices. The products purchased must meet USDA specifications.

CCC has no operating personnel; its programs are carried out primarily through the personnel and facilities of USDA's Agricultural Stabilization and Conservation Service (ASCS). ASCS' Kansas City, Missouri, Commodity Office (KCCO) is responsible for acquiring, handling, storing, and

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processing the dairy products, as well as examining public warehouses.[1] USDA's Agricultural Marketing Service (AMS) inspects and grades the products at the time of purchase and at certain prescribed intervals while in storage.

Because milk is highly perishable, it must be marketed quickly, for either consumption in fluid form or transformation into storable manufactured products, such as butter, cheese, and nonfat dry milk. To help ensure that the average farm-level price of milk does not fall below the support level, CCC purchases the manufactured dairy products from processing firms at a price based on the support price plus an allowance for processing costs. Because most products are purchased in bulk form, ASCS normally has to contract with commercial firms to reprocess the products into consumer ready-to-use form before distribution.

USDA Inventory Operations

CCC-owned dairy products are stored in public warehouses until donated, sold, or bartered. ASCS maintains a computerized perpetual inventory for all CCC-owned, warehouse-stored dairy products. The computerized system provides, among other things, a detailed listing of the quantity and condition of products stored in each warehouse and whether they have been committed to fill orders or are available for use. The system also accounts for all transactions, such as acquisitions, transfers to processing plants, sales, and donations and provides periodic reports on errors and omissions.

At least twice a year, ASCS personnel examine each warehouse to ensure that the CCC-owned products are properly cared for. The purpose of the warehouse examinations is to check on such things as cleanliness and rodent control and to verify the quantities of products stored.

Also, periodic inspections of the quality of CCC-owned products stored in the warehouses are made by AMS personnel. These inspections are made by licensed inspectors who determine, on a sample basis, whether the stored products continue to meet USDA's grading requirements. The frequency of these inspections varies by product type and form, ranging from 3 to 4 months for cheese stored in 500-pound barrels to 6 to 7 months for nonfat dry milk stored in 50-pound bags.

[1]Responsibility for warehouse examinations was transferred from USDA's Agricultural Marketing Service to ASCS in May 1984.

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Because CCC must purchase all dairy products offered it that meet specifications, the quantities of products to be acquired or the locations at which the products will be acquired are not subject to management control. Also, ASCS has little control over the quantities of products to be donated under the various FNS commodity donation programs. Thus, ASCS' inventory management decisions are limited to matters relating to the care of the products and the efficiency with which the acquired products are managed.

USDA's purchases of surplus dairy products rose from about $247 million in fiscal year 1979 to about $2 billion in fiscal year 1984. For the same years, storage, handling, and transportation costs associated with these products rose from about $23.2 million to about $156 million. Although USDA donated, sold, and bartered large quantities of the products it purchased, the value of its dairy inventory rose from about $570 million at the end of fiscal year 1979 to about $4.1 billion at the end of fiscal year 1984, before dropping to $3.1 billion in August 1985.

Temporary Emergency Food Assistance Program

The Agriculture and Food Act of 1981 (Public Law 97-98, Dec. 22, 1981) directed USDA to use all available authorities to reduce its dairy product inventories. In December 1981 USDA responded by making CCC-owned cheese available to states for distribution to the needy. This effort evolved into the special distribution program that provided butter, cheese, nonfat dry milk, and other surplus products to states for distribution to the needy.

The Temporary Emergency Food Assistance Act of 1983 (Title II of Public Law 98-8, Mar. 24, 1983), which formalized the special distribution program, directed USDA to make all CCC commodities, in excess of quantities needed for other fiscal year 1983 programs and activities, available for distribution to the needy. It also appropriated $50 million to reimburse state and local agencies for costs incurred in storing and distributing products in fiscal year 1983.

Also, title I of the act appropriated $75 million for the purchase and distribution of perishable agricultural commodities during fiscal year 1983 for use in high unemployment areas. These commodities were to be made available through state agencies to emergency feeding facilities (commonly referred to as soup kitchens) that provided congregate nutrition services to indigent persons.

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Public Law 98-92, enacted September 2, 1983, extended TEFAP through fiscal year 1985 and authorized an additional $[illegible] million for state and local program costs in each of fiscal years 1984 and 1985. Public Law 98-92 also requires the Secretary of Agriculture to, among other things, provide commodities to the states in such quantities as can be used without waste and take such precautions as the Secretary considers necessary to assure that the commodities made available do not displace commercial sales. Regarding commercial sales displacement, the act requires that the Secretary not make commodities available for donation in any quantity or manner that he determines, in his discretion, may substitute for the same or any other agricultural produce that would otherwise be purchased.

Public Law 99-88, enacted August 15, 1985, appropriated an additional $7 million to cover storage and distribution expenses incurred by state and local agencies through March 31, 1986. According to a USDA official, USDA will, as a result of this act, continue the program through March 31, 1986.

Program Administration

FNS has overall responsibility for administering TEFAP at the federal level. To implement TEFAP, FNS issued interim rules on April 26 and December 16, 1983. These rules, among other things, require that state and local agencies maintain accurate and complete records to document the receipt, disposal, and inventory of TEFAP products and set forth the allocation formula FNS uses to make funds and commodities available to states. The formula provides that the allocation be based 60 percent on the number of persons in households within the state having incomes below the poverty level and 40 percent on the number of unemployed persons within the state. In some cases, a state may not wish to accept its full allocation of products, in which case FNS will offer these products to other states.

Each state selects one of its agencies to administer the distribution of TEFAP products within the state. Frequently, the state agency administering TEFAP also administers FNS' traditional donation programs. The states generally have agreements with local government and charitable organizations that administer TEFAP at local levels. The local administering agencies may have other organizations distribute the products to program participants, distribute the products themselves, or use a combination of both.

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Once the quantities of products to be allocated are agreed on by FNS and the states, a state may submit orders for products to the appropriate FNS regional office, which in turn orders the products from ASCS. In filling orders received, ASCS contracts for the transportation services necessary for moving products from the warehouses ASCS uses to store the products to central distribution centers in each state. The state and local distributing agencies perform the remaining tasks: transporting the products to local distribution centers, unloading the products, organizing and publicizing distribution activities, and staffing the distribution sites. Much of the work at the local sites has been performed by volunteers.

Program Activity

From the program's inception in December 1981 through November 1984, FNS provided the states with about 1.8 billion pounds of products valued at about $2.3 billion. Included in this were about 1.56 billion pounds of dairy products valued at about $2.25 billion. Table 1.1 shows the quantities of commodities made available to the states.

Table 1.1: TEFAP Products Made Available to States, December 1981-November 1984

Pounds and dollars in millions

Commodity	Date product was first made available	TEFAP products made available to states through November 1984	
		Quantities (pounds)	Value
Dairy products:			
Processed cheese	Dec. 1981	926	$1,343
Butter	Feb. 1982	335	510
Cheddar cheese	Mar. 1983	183	277
Nonfat dry milk	May 1983	114	123
Total—dairy products		**1,558**	**2,253**
Other products:			
Cornmeal	Apr. 1983	59	9
Rice	Apr. 1983	29	0
Honey	June 1983	82	58
Flour	July 1983	87	11
Total—other products		**257**	**84**
Total—all products		**1,815**	**$2,337**

Objectives, Scope, and Methodology

We made this review as a result of requests by the Chairman and Ranking Minority Member of the Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations;

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Senator John Heinz; and Representatives William H. Gray, III, William F. Clinger, Jr., and Mary Rose Oakar. Because the requests all related to concerns about surplus products owned by USDA and donated to states, the requestors agreed to our addressing their concerns in one review.

In accordance with agreements reached with the requestors, our overall objective in this review was to determine whether USDA's and the states' inventory management systems assured that the surplus products owned by CCC and donated to the states were properly controlled and efficiently managed by minimizing transportation and storage costs. We also agreed to obtain information on the decision-making process USDA follows in determining the quantities of products to purchase in bulk and ready-to-use form. We satisfied other concerns the requestors raised through oral briefings and a separate report issued to Representative Oakar in January 1985 on the age, condition, and value of CCC-owned dairy inventories.[2]

We made our review at AMS, ASCS, and FNS headquarters offices in the Washington, D.C., area; at the four FNS regional offices having jurisdiction over the states reviewed—the northeast, mid-atlantic, midwest, and western regions; at ASCS' Kansas City, Missouri, Commodity Office; and in four states—California, Michigan, New York, and Pennsylvania. We were asked to review Michigan's program by Representative Clinger and Pennsylvania's program by Senator Heinz and Representatives Clinger and Gray. In Michigan and Pennsylvania, we reviewed the design and implementation of the states' inventory management systems.

To supplement our reviews in Michigan and Pennsylvania and to obtain somewhat broader coverage, we also visited California and New York to obtain information on their inventory management systems. We chose California and New York because they were two of the top states in terms of the quantity of dairy products distributed under TEFAP as of May 31, 1984. Although our review of TEFAP in these two states focused on the design of the states' inventory management systems, we did obtain information on their implementation through discussions with FNS, state, and local officials and by reviewing available evaluation reports.

In reviewing USDA's and the states' inventory management systems, we did not determine the extent of lost or spoiled products. Also, the results

[2]Government-Owned Surplus Dairy Products Held in Inventory (GAO/RCED-85-43, Jan. 7, 1985).

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of our review of the four states are not statistically projectable to the nation. Coupled with our review of the FNS headquarters' and regional offices' procedures, however, our review results provide an assessment of FNS' efforts to ensure that the states and local agencies have adequate inventory management systems.

To obtain information on the decision-making process USDA follows in determining the quantities of products to purchase in bulk and ready-to-use form, we interviewed ASCS officials and reviewed ASCS records on purchases of dairy products in bulk and ready-to-use form.

Our review generally covered the period June 1984 through December 1984, and was made in accordance with generally accepted government auditing standards. Also, to the extent practical, we obtained updated or supplemental information through September 1985. We reviewed reports issued by USDA's Office of the Inspector General (OIG) on TEFAP and other commodity donation programs. We also used information from our ongoing work on (1) an audit of CCC's fiscal year 1984 accounts and financial statements and (2) the adequacy of USDA's effort to implement the requirements of the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512). The following sections discuss our methodology in more detail.

USDA's Inventory Management System

To determine whether USDA's inventory management system assured that surplus dairy products owned by CCC were properly controlled and cared for, we reviewed and evaluated the design of the system and made selected tests of its implementation. In evaluating system design, we reviewed applicable policies and procedures governing the controls over receipts, disposals, and inventories; analyzed, and prepared a table showing, the controls used to account for products shipped to and from warehouses (see app. I); and discussed the system's design with ASCS officials. In reviewing system implementation, we compared ASCS' perpetual inventory records with those maintained by a randomly selected sample of 88 warehouses; accompanied ASCS warehouse examiners to 6 warehouses to determine whether their examinations conformed with ASCS requirements, including those dealing with physical inventories and reconciliation of ASCS and warehouse inventory records; reviewed ASCS records to determine whether the 470 warehouses used by ASCS as of June 30, 1984, were examined at least twice a year in accordance with ASCS' requirements; and reviewed a selected sample of 11 of 112 hold actions ASCS had placed on 111 warehouses to determine whether ASCS officials had taken prompt action to prevent shipment of products to

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warehouses determined to be in noncompliance with ASCS procedures by ASCS examiners. We also reviewed ASCS warehouse examination reports to determine the condition of the warehouses, reviewed AMS records to determine whether product quality inspections were made in accordance with the frequency standards prescribed by ASCS, and interviewed ASCS and AMS officials responsible for warehouse examinations and product inspections.

To determine whether USDA efficiently managed transportation and storage costs, we interviewed ASCS officials and reviewed selected inventory management areas related to transportation and storage costs that we considered had potential for achieving efficiencies. We did not attempt to determine the overall efficiency with which ASCS managed the huge volume of dairy products purchased, stored, processed, and donated and sold because we considered such an effort to be beyond the scope of this review. To determine whether ASCS' policies and procedures were effective in minimizing transportation and storage costs, we reviewed ASCS' policies and procedures governing the selection of warehouses in which to place acquired products and from which products were used to fill state orders or to send to commercial firms for processing. We reviewed, among other things, the (1) selection of warehouses in which 19 purchases of cheese were placed to determine whether the products were sent to warehouses near the point of purchase, (2) level of products maintained in nine warehouses charging rates above the national average to determine whether ASCS was taking advantage of the increased flexibility it had, due to reduced inventories, to use warehouses charging lower storage rates, (3) selection of commercial firms to carry out 35 processing contracts to determine whether products were sent to the closest firms, and (4) selection of warehouses from which products were used to fill 119 state orders to determine whether the products were shipped from the nearest warehouses.

State Inventory Systems

To determine whether the states' inventory management systems assured that TEFAP products were properly controlled, managed, and cared for at the state and local levels, we reviewed and evaluated the design of the systems used by the four states and made selected tests of system implementation in two states (Michigan and Pennsylvania). In evaluating system design, we interviewed FNS, state, and local officials and reviewed applicable FNS and state policies and procedures governing the controls over the receipt, disposal, and inventory of TEFAP products by state and local distributing agencies. We reviewed state operating plans, state and local agency agreements, state warehouse contracts,

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various accounting records and forms used to control products, and FNS and state program guidance. We also reviewed the recordkeeping systems of several local agencies—three in both California and Pennsylvania, two in Michigan, and one in New York.

In reviewing system implementation in Michigan and Pennsylvania, we tested the procedures the states used to ensure that products they ordered from FNS were received, reviewed state and warehouse records to determine the accuracy of inventory records and whether required physical inventories were taken and reconciled to book inventories, reviewed the latest available warehouse examination reports, and made such other tests of accounting controls that we considered necessary. We also reviewed available FNS and state reports on evaluations made of local agency programs.

In evaluating FNS monitoring of state and local agency programs, we interviewed FNS officials and reviewed the monitoring efforts carried out by the four regional offices visited. We reviewed the latest available FNS regional office evaluation reports of state programs made by three of the four regional offices visited (one office made no evaluations of state TEFAPs). We reviewed selected FNS field office evaluation reports of local agency programs and national and regional summaries of the results of such evaluations. We also determined whether state inventory reports submitted to the regional offices were reviewed by regional officials to monitor state inventory levels.

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USDA's Inventory Management System Provides Control Over Dairy Inventory

Our review and evaluation of the inventory management system used by ASCS' Kansas City Commodity Office to control the receipt, disposal, and inventory of billions of pounds of CCC-owned dairy products showed that it was properly designed and implemented. Also, ASCS warehouse examiners were examining warehouses in accordance with agency procedures designed to ensure that the products stored in public warehouses are properly cared for. Further, our review of selected shipments of products to and from warehouses and analysis of storage and transportation costs showed that ASCS managed the storage and transportation costs of these products efficiently.

Inventory Management System Provides Adequate Control Over the Receipt, Disposal, and Inventory of Dairy Products

The ASCS inventory management system is designed to control the receipt, disposal, and inventory of CCC-owned dairy products. Our selected tests indicated that the system was generally implemented as designed.

ASCS maintains a computerized perpetual inventory record of all dairy products stored in the public warehouses it uses. The computerized system provides, among other things, a periodic detailed listing that shows, by lot[1] number, the quantity and condition of products stored in each warehouse and whether they have been committed to fill an order or are available for use. The system also accounts for all transactions, such as acquisitions, transfers to processing plants, sales, and donations, and provides periodic reports on errors and omissions.

Controls Over Receipts

Once the product is purchased and a storage site is selected, KCCO prepares a multipart shipping document (form KC-269, notice to deliver). The various copies of the form are used to enter pertinent acquisition data on ASCS' inventory records, to serve as a warehouse receiving document to assure that the products are received at the designated warehouse, and to provide authority for payment to the processors and shipping firms. Each lot of products purchased is assigned a number for identification and control purposes. This process is described in more detail in appendix I.

Controls Over Dispositions

The multipart shipping document used to control receipts is also used to control products shipped to commercial firms for processing the bulk products into ready-to-use form and to the recipients of the products.

[1]A "lot" refers to a designated quantity of products, generally a railcar lot or a truckload.

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Since most products purchased under the price-support program are in bulk form, they have to be processed into ready-to-use form before they are sent to recipients. Once the products are processed, they are either returned to ASCS storage (not necessarily to the same warehouse where they were initially stored) or sent directly to the recipients.

The shipping document then is used to adjust the book inventory, assure receipt of products at the destination point, and authorize payment for processors and shipping firms. Because nearly all domestic distributions are made under FNS commodity donation programs, we concentrated on this system. ASCS and FNS have an integrated computerized system to control orders and shipment of products. This system is described briefly below.

- The seven FNS regional offices are responsible for entering into the computer daily (1) the states' orders for products for the various donation programs and (2) any changes to the orders.
- After an order is entered, the computer issues worksheets containing information, such as type and quantity of product, that the KCCO staff use to arrange for delivery of the products to the destinations designated by the states. The KCCO staff select which warehouse or processor will fill the order and then enter shipping data in the computer. The computer issues shipping instructions that are sent to the selected shipper setting forth what, where, how, and when to ship. Copies of the shipping instructions are also used to control other aspects of the shipment, such as freight payment and verification of delivery.
- The shipper (warehouse or processor) notifies both FNS and the state distributing agency that placed the order with FNS when the shipment can be expected at the destination. FNS is responsible for entering into the computer file that the product has been shipped, and the state distributing agency is responsible for notifying the ultimate receiver that the shipment is on its way.
- Upon receiving the shipment, the recipient prepares a receiving document acknowledging delivery and records any shortages, overages, and damages. This information is sent to ASCS through FNS and becomes the source data for entry into the computer to show delivery, generate any monetary claims, adjust inventory records, and record the activity in CCC's financial accounts.
- The system also provides reports to track orders and shipments and to make necessary corrections. A daily list of FNS order cancellations and corrections is one. Another is a daily list of computer-rejected orders along with the reason for rejection, such as a duplicate record already on file. Others are a daily list of rejected notices to ship and rejected

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receiving notices, and a list of delinquent shipments. FNS also receives a weekly shipment and delivery report by region showing shipment and receipt information for each order.

In our opinion, USDA's procedures and pertinent instructions contained in various detailed handbooks governing the receipt and disposal of products provide a system that, if properly implemented, will account for shipments and deliveries of dairy products. Further, the system-generated reports provide additional controls to help ensure that errors or acts of omission are detected.

Controls Over Inventory

As described above, a computerized perpetual inventory is maintained for all CCC-owned dairy products. Twice each year, or more often if deemed necessary, ASCS warehouse examiners are to make unannounced examinations of each warehouse that stores CCC-owned dairy products. During these visits, the examiners are to reconcile ASCS' book inventory with the warehouse's book inventory and inspect warehouse conditions.

During one of the two examinations, the examiner is required to physically count a 10-percent randomly selected sample of the products in store and, for the remaining products, verify that all lots listed on the book inventory are properly accounted for. During the other examination, the examiner verifies that all lots are accounted for.

In examining warehouse conditions, the examiners are to evaluate such matters as cleanliness, rodent and insect control, and the adequacy of fire protection, ventilation, and storage temperatures and to observe the general condition of stored products. The ASCS employees making examinations are periodically rotated so that a warehouse is not continuously examined by the same person. An examiner's manual and various forms serve as guides for the examiners and the forms provide standard reporting of the results. Deficiencies are reported for follow-up action to KCCO units responsible for warehouse contracts and for selecting warehouses.

As of June 30, 1984, CCC-owned dairy products were stored in 470 public warehouses. Our review of warehouse examination records showed that of the 470 warehouses, 415 (about 88 percent) were examined at least twice during fiscal year 1984. Of the remaining 55 warehouses, 33 were examined once during the year but had also been inspected during the month either preceding or subsequent to fiscal year 1984. We considered these warehouses to have been inspected in compliance with

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ASCS requirements. An additional 18 warehouses did not require two examinations because products were not stored in them for the entire year. That leaves only four warehouses, or less than 1 percent, that had not been examined the required number of times. Because of the small number involved, we did not try to determine why the four warehouses were not examined at least twice.

ASCS Had Taken Prompt Action to Discontinue Using Warehouses Placed on Restriction

Our review of a randomly selected sample of 11 of 111 warehouses put on restriction showed that ASCS followed its procedures to stop shipments of new products to the warehouses in a timely manner.

ASCS places a warehouse on restriction (referred to as a hold) so that ASCS staff will not ship additional dairy products to the warehouse. Some warehouses are placed on hold based on an action they initiate; for example, the warehouse may wish to terminate its contract, be going out of business, or be for sale. Other warehouses may be placed on hold based on an ASCS determination that a warehouse is not adequately meeting ASCS warehousing requirements; for example, the warehouse may not be meeting ASCS financial equity requirements or prescribed standards on warehouse conditions.

During fiscal year 1984, ASCS had placed 112 hold actions on 111 warehouses. To determine whether ASCS was implementing its procedures promptly and properly, we randomly selected a sample of 11 hold actions for review. Of the 11 actions, 5 were the result of a warehouse action, and 6 were the result of an ASCS action. Of the six warehouses placed on hold due to an ASCS action, one was put on hold because of unacceptable warehouse conditions, one failed to meet financial equity requirements, three failed to submit timely or sufficient financial data, and one involved a procedural action to change the ASCS warehouse identification number.

ASCS inventory records for the 11 warehouses reviewed showed that no additional products were shipped to the warehouses by ASCS once the holds were in place. Also, in the case of the warehouse that had unsatisfactory conditions, ASCS had instituted the hold action within about 21 days after the warehouse examiner recommended the hold action. Also, ASCS staff worked with the warehouse to correct noted problems and examined the warehouse 5, 10, and 11 months after the hold was put in place. The quantity of CCC-owned nonfat dry milk stored in the warehouse was reduced by only 15 percent after the hold was put in place because, according to an ASCS official, the stock stored in the warehouse

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was relatively new and, in conformance with ASCS' practice to rotate stock by using old stock first, ASCS used older stock from other warehouses to fill orders.

ASCS had previously required the warehouse that failed to meet ASCS' financial equity requirements,[2] to take out a $250,000 performance bond to protect the government's interest. Because of the warehouse's failure to meet ASCS' financial equity requirements and a conflict between ASCS and the warehouse over financial responsibility for damaged products, ASCS decided to stop placing additional products in the warehouse. After the hold action was taken, the quantity of nonfat dry milk stored in the warehouse was substantially reduced, from about 5 million pounds in August 1984 to about 2 million pounds in December 1984.

For the three warehouses that did not submit timely or sufficient financial data, ASCS, after unsuccessful attempts to get the data, put the warehouses on hold from 4 to 52 days after the date the financial data were to be submitted. In our opinion, ASCS acted prudently in trying to work with the warehouses to obtain the required data before putting them on hold.

Warehouse Examinations Conformed to ASCS Procedures

In selecting the six warehouses to visit, we chose warehouses scheduled for examination so as not to disrupt normal activities. We also considered geographic dispersion, the type(s) of storage provided by the warehouse (i.e., dry, cooler, or freezer), type(s) of products the warehouse stored (i.e., butter, cheese, or nonfat dry milk), and whether or not a physical inventory was scheduled. Except for one warehouse, which was visited in August 1984 as part of our office's audit of CCC, we visited the warehouses in October 1984. Table 2.1 provides a brief profile of the warehouses visited.

[2]ASCS requires that a warehouse have a net worth of $25,000 to $250,000, depending on the value of commodities stored.

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Table 2.1: Profile of Warehouses GAO Visited

Location	Type(s) of storage[a]	Type(s) of product stored[a]	Annual physical inventory scheduled
Maryland	freezer	butter	yes
Minnesota[b]	dry	nonfat dry milk	no
Missouri	dry	nonfat dry milk	yes
Missouri	dry	nonfat dry milk	no
Missouri	freezer & dry	butter & nonfat dry milk	no
Pennsylvania	freezer	butter	yes

[a]One warehouse we initially selected had cheese stored in cooler storage, but it was not fully examined because of the unexpected amount of time spent examining a warehouse with problems.

[b]Warehouse visited in August 1984 as part of audit of CCC activities.

The examiners made their examinations in two phases. The first phase—the record review—included a reconciliation between the ASCS book inventory and the warehouse book inventory and a review of the monthly pest control and daily temperature records. During the second phase, the examiners visually inspected the storage areas and stored products and determined that each lot listed on the warehouse book inventory was stored in the warehouse and that the quantities of each stored lot approximated the quantities shown on the inventory record. Also, for the three warehouses scheduled for a physical inventory, the examiners physically counted a 10-percent randomly selected sample of the products as required and, for the remaining 90 percent, determined that each lot listed on the book inventory was stored in the warehouse and that the quantities were approximately correct.

Regarding warehouse conditions, only one warehouse had any significant problems. At this warehouse, the examiner found that (1) warehouse records showed that freezer temperatures exceeded USDA maximums,[3] (2) products were stored in unapproved areas, (3) undesirable frost and ice had accumulated on products, (4) several areas of the warehouse contained debris, and (5) cartons containing 680 pounds of butter were damaged. The examiner also found a mix-up in the inventory records involving four lots of butter. Two lots, totaling about 85,000 pounds, were erroneously shipped in place of two other lots of the same quantity.

[3]USDA considers any temperature deviation for frozen butter a major problem because the butter may deteriorate when temperatures exceed required maximums frequently or for several days at a time.

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Although the warehouse began taking corrective action during our visit, the examiner recommended that no additional products be stored in the warehouse until the warehouse could better assure that it could meet temperature requirements. In following up on this matter, we learned that as of December 31, 1984, all the butter had been removed from the warehouse. Further, during our visit, the examiner prepared an inventory adjustment notice to initiate a reimbursement claim for the damaged products and began to correct inventory records for the mix-up on the lots shipped by the warehouse.

As discussed earlier, our office also audited CCC's fiscal year 1984 accounts and financial statements. As a part of that audit, we confirmed the accuracy of the inventory balances at 88 warehouses storing dairy products. Confirmation notices returned by the warehouses showed that 3 had fewer products stored than ASCS records showed, and 20 had more. The net difference amounted to about 1 percent of all commodities stored in the 88 warehouses. We were able to reconcile all the differences, which were caused by delays in processing paperwork. In addition to confirming inventory balances, the audit included tests of internal controls over receipts, payments, and inventories and tests of financial accounts.

Inventory Practices Reviewed Were Generally Efficient

The inventory management practices ASCS followed for the selected shipments we reviewed, in terms of selecting warehouses, paying storage rates, selecting processors, and shipping orders, were handled efficiently.

In fiscal year 1984, USDA purchased about 1.7 billion pounds of dairy products, distributed and sold about 2.1 billion pounds of products during the year, and had about 3.4 billion pounds of products in inventory at year end. We did not try to determine the overall efficiency with which ASCS managed these huge volumes of dairy products but rather examined selected inventory management practices that we considered to have potential for achieving efficiency. The practices we reviewed are discussed briefly below and in greater detail beginning on page 27.

- ASCS' selection of warehouses in which to store 19 purchases of bulk cheese, totaling about 5.5 million pounds, generally conformed with ASCS' policy of placing products in warehouses near the point of purchase to help minimize transportation costs.
- The above-selected warehouses had storage price rates below the national average. Also, the quantity of products stored at eight of nine

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warehouses that charged rates above the national average had declined substantially from June to October 1984. The ninth warehouse had increased quantities but was used because of location advantages.

- About 122.5 million pounds of bulk cheese selected for processing were generally sent to the closest processors.
- About 23.9 million pounds of processed cheese used to fill 119 orders were generally shipped to the designated destinations from the nearest warehouse or processor.

In a May 1982 report,[4] we said that it can cost USDA more to repackage bulk butter for various donation programs than if the butter is initially bought in 1-pound packages. ASCS now buys some products in ready-to-use form and, according to an agency official, ASCS will be in a better position to purchase more products in ready-to-use form as more of the bulk products are used.

Overall Efficiency of ASCS Management Difficult to Assess

The huge volume of dairy products ASCS purchases, stores, processes, and donates or sells, as well as the many subjective judgments that must be made in managing this activity, makes it difficult to assess the overall efficiency with which ASCS managed the dairy inventory.

As shown in table 2.2, purchases of surplus dairy products and resulting inventories increased rapidly over the past several years before declining from fiscal year 1983 levels in fiscal year 1984. In addition, dispositions of dairy products increased from about 491 million pounds in fiscal year 1979 to about 2.1 billion pounds in fiscal year 1984. This increased workload increased storage and transportation costs.

Table 2.2: USDA Dairy Product Purchases and Inventory, Fiscal Years 1979-1984

Pounds and dollars in millions

	Purchases		Ending stocks	
Fiscal year	Pounds	Cost	Pounds	Value
1979	272.1	$ 246.7	705.2	$ 569.8
1980	1,124.5	1,262.4	1,216.8	1,266.4
1981	1,620.3	1,990.7	2,005.6	2,395.6
1982	1,863.2	2,282.4	2,836.7	3,441.6
1983	2,186.2	2,716.0	3,486.0	4,219.4
1984	1,658.3	1,983.2	3,378.3	4,102.4
1985 (through August 1985)	1,385.9	1,605.7	2,624.0	3,065.2

[4]Savings Are Possible Through Better Management of Government- Owned Dairy Products (GAO/CED-82-79, May 18, 1982).

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As a result of increased purchases of dairy products, storage, handling, and transportation costs increased from about $23.2 million in fiscal year 1979 to about $156.4 million in fiscal year 1984, an increase of about 575 percent. Storage and handling costs, which reflected both the increased inventory size and increasing storage rates, increased from about $10.4 million in fiscal year 1979 to about $79.3 million in fiscal year 1984. As the number of warehouses used increased, so did the average storage rates. From June 1981 to June 1984, the number of warehouses used increased from 316 to 470, while the average monthly rate for storing 100 pounds of butter increased from 27.5 cents to 29.1 cents, the average for cheese increased from 24 cents to 25.3 cents, and the average for nonfat dry milk increased from 7.5 cents to 8.2 cents. Transportation costs increased from about $12.8 million in fiscal year 1979 to about $77.1 million in fiscal year 1984. As a result of the increased activity after 1979, USDA staff resources used to inspect products and examine warehouses also increased, as discussed below.

During 1980 and 1981, when the large inventory increases were just beginning, USDA had difficulty locating both acceptable and sufficient storage in desirable locations. Storage space for cheese was the biggest problem because the inventory increased from about 3.7 million pounds in September 1979 to about 619.5 million pounds in September 1981. As a result, much of the cheese was stored wherever space could be quickly located and not necessarily in the most desirable location.

The increase in activity under the price-support program required USDA to increase the staff resources devoted to managing the dairy inventory. For example, AMS' Dairy Grading Section, which is responsible for making quality inspections of the inventory, increased from 140 full-time employees in October 1981 to 175 in March 1985, a 25-percent increase. Also, staff years spent in examining warehouses storing CCC-owned dairy products increased from about 7.2 to 8.9 years from fiscal year 1979 to fiscal year 1984.

Inventory Management Decisions Rely Heavily on Subjective Judgments

Under the price-support program, USDA must purchase all quantities of surplus dairy products offered it and meeting specifications and, therefore, ASCS has virtually no control over the quantities of dairy products to be acquired or the locations the products will be acquired from. Further, ASCS has little control over the quantity of products to be donated under the various FNS commodity donation programs. Hence, ASCS' inventory management decisions are basically limited to such matters as selecting the warehouses in which to store the products, the specific

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products used to fill orders, the firms that will process the bulk products, and the means by which the products will be transported.

ASCS has established overall policy guidelines for its staff to follow in deciding where to store the products and which products to use to fill orders. Using these policy guidelines and their own experience, the staff must consider a large number of variables before choosing the best alternative. For example, the staff must select the warehouse that products should be stored in considering such factors as transportation costs, storage sites, locations of firms that will process the products, and probable areas where the products will be distributed. According to ASCS officials, management periodically reviews selected staff decisions to help ensure that the decisions conform with ASCS policies and procedures.

ASCS Considered Transportation and Storage Rates in Selecting Warehouses to Store Acquired Products

ASCS was generally following its policy to locate acquired products in warehouses as near the point of purchase origin as possible. Because the final destination of the products is unknown at the time of purchase, ASCS follows this policy in an effort to minimize transportation costs. ASCS also appeared to have taken advantage during fiscal year 1984 of the increased flexibility it had due to lower purchases and inventories to select warehouses with lower rates.

Under the price-support program, ASCS has no say in deciding where or from whom dairy products will be purchased, as long as the products meet USDA's specifications. The first inventory management decision officials must make then is where to locate the products. ASCS' policy is that the bulk products should generally be placed in warehouses as near the point of origin as possible. This policy is designed to minimize transportation costs from the point of origin to the warehouse and to provide ASCS management with flexibility in deciding where the bulk products are to be processed.

Our review of the placement of 5.5 million pounds of surplus cheese acquired under 19 purchase contracts during the first 23 days of October 1984 showed that 12 of the 19 purchases, or about 63 percent, were placed in warehouses within the state in which they were purchased. Two were sent to warehouses in cities where processors were located. Although the remaining five purchases were placed in warehouses outside the state in which they were purchased, these exceptions to ASCS' policy appeared reasonable.

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Two of the five purchases were made in Iowa and South Dakota and the products sent to warehouses in Illinois and Ohio. The ASCS staff person responsible for placement decisions told us that, in these cases, the products were positioned in warehouses enroute to contract cheese processors located in Ohio and Pennsylvania where the products were needed.

We did not question warehouse placements for the remaining three purchases because the decisions appeared reasonable based on storage rate differentials and processing capability available. In these three cases, the purchases were made in Minnesota and North Dakota and the products shipped to Wisconsin warehouses. Following ASCS' policy, the purchases should have been located in Minnesota; however, processing capability is greater in Wisconsin than it is in Minnesota. For example, during the first 6 months of 1984, contractors in Wisconsin processed 160 percent more cheese than did those in Minnesota. Further, warehouse storage rates in Wisconsin for cheese averaged about 3 cents lower per 100 pounds of cheese than the average rates in Minnesota as of June 1984.

When inventory levels decrease, ASCS can be more selective in using warehouses with lower storage rates. ASCS appeared to have taken advantage of this situation in 1984. For example, our analysis of the placement of the 5.5 million pounds of cheese just discussed showed that the products were placed in warehouses charging an average monthly rate of 24.5 cents per 100 pounds compared with the national average rate of 25.3 cents in June 1984.

We also reviewed the activity at nine warehouses in Kansas, Missouri, and Wisconsin that had storage rates for cheese that were above the national average to determine whether ASCS had reduced inventories at these warehouses. We found that the agency had reduced inventories at all but one warehouse. As of October 1984, four of these nine warehouses had no cheese placed in them for more than 1 year and had from 4 to 69 percent less cheese stored than they did in June 1984. Another warehouse was no longer used at all, and three of the nine warehouses had some additional cheese placed in storage since June 1984, but had from 20 to 69 percent less cheese in storage in October than in June. The quantity of cheese stored in the remaining warehouse had increased by about 2 1/2 times. According to the ASCS staff member responsible for placing the cheese, the cheese was sent to this Missouri warehouse because (1) the cheese was scheduled to be donated soon to the states of Missouri and Kansas and (2) nearby warehouses with lower storage

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rates prefer the more easily stored barrel cheese rather than block cheese, which this cheese was.

Policies Followed in Selecting Products for Processing and Filling Orders Appeared Reasonable

The selection of products used to fill orders requires that a large number of variables be considered. We did not evaluate all the variables involved in shipping decisions because such a review would have required considerable computer programming effort. We did, however, make some selected analyses that showed that, considering the volume of activity confronting ASCS and the complexity of the decision-making process, the agency appeared to have done a reasonable job of selecting products to fill orders.

Before being distributed, many bulk products have to be processed into ready-to-use form. In selecting the firms used to process products, ASCS prepares and publicizes invitations to bid, and the invitations are sent to known processors. In analyzing the bids received, transportation costs are considered. Successful bidders are notified and the awards announced. Once processed, the products may be sent directly to recipients or returned to storage for future use.

Dairy product donations and sales are made both domestically and to foreign countries. For fiscal year 1984, 61 percent of all donations were domestic, and 39 percent were foreign. Although the selection of products to process and/or fill orders is basically subjective, in arriving at their decisions, ASCS staff are required to consider the

- product's suitability for the particular program involved;
- recommendations by commodity inspectors and warehouse examiners to use specific lots in specified warehouses;
- prospects for continued safe storage, considering geographic location and other factors that influence deterioration;
- ability to meet shipping schedules, considering the volume warehouses are capable of shipping;
- transportation costs; and
- products' age, and within each age category, the currentness of quality inspection certificates.

ASCS also provides the following specific requirements for designated programs.

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- For domestic, nonfederal agency use, butter repackaged from bulk stock shall be U.S. grade A or better prior to repackaging. (For other programs, bulk butter shall be U.S. grade B or better.) Cheese shall be U.S. grade B or better, and nonfat dry milk shall be U.S. extra grade.
- The first consideration when supplying cheese to processors is to use grade B or lower cheese. Transportation costs for such cheese are a secondary consideration. After using grade B or lower cheese, any cheese may be used if good commercial practices are followed.

Selecting which cheese to pull from warehouses is further complicated because processing the natural cheddar cheese into American cheese requires blending the natural cheddar to achieve an acceptable taste. As a general rule, about 25 percent of the bulk cheese selected for processing must be no more than 6 months old, and no more than 20 percent can be in block form.

We reviewed the selection of bulk cheese for shipment to processors to determine whether, based on geographic distance shipped, the selection appeared reasonable. About 122.5 million pounds of cheddar cheese were processed by 16 firms under 35 separate contracts during the 6 months ended June 30, 1984. Information on the contracts is shown in table 2.3.

Table 2.3: Processing Contracts Awarded for January to June 1984 Delivery

Pounds in millions

Location of processors	Number of processors	Number of contracts	Quantity shipped for processing
Wisconsin	8	14	50.3
Minnesota	2	7	19.6
Missouri	2	5	22.4
Pennsylvania	2	6	22.4
Ohio	1	2	1.1
Utah	1	1	6.7
Total	**16**	**35**	**122.5**

Of the 122.5 million pounds of cheese, about 5.6 million pounds had not been sent to the closest processor. This included about 2.9 million pounds that were shipped from California, Colorado, and Nevada warehouses to Minnesota and Wisconsin processors when another processor was located in Utah. According to the responsible ASCS official, the cheese was shipped to the Midwest because the western states had an oversupply of bulk cheese in block form. Our review of 94 million

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pounds of CCC-owned bulk cheese stored in western states showed that nearly 75 percent was in block form. The explanation for the other 2.7 million pounds not sent to the closest processor was that the cheese was selected to meet blending requirements to assure an acceptable taste. In reviewing these shipments, we found that about half were sent to Ohio and Pennsylvania processors that ASCS had difficulty supplying with bulk cheese, and the shipping distances between alternative processors for the remainder indicated little potential savings.

Our review of the selection of cheese that was shipped in June 1984 to fill TEFAP orders for 23.9 million pounds of American cheese in 5-pound loaves showed that the selections were generally reasonable. The cheese shipments involved 295 separate orders for 119 locations and originated from 42 warehouses and 9 processors. About 10.5 million pounds of the cheese were shipped to recipients from the warehouses, and 13.4 million pounds were shipped from the processors' plants.

In analyzing the 10.5 million pounds of cheese shipped from the 42 warehouses, we found that although about 4.8 million pounds, or about 45 percent, were shipped to locations outside the states in which the cheese was stored, most of the 4.8 million pounds were shipped to states in which ASCS had no cheese stored.

Regarding the cheese shipped from processors' plants, the selection decisions on all but about 148,000 of the 13.4 million pounds appeared reasonable based on the geographic distance shipped. According to an ASCS official, the shipments, which went from Minnesota and Wisconsin processors to California, were necessary because the one western processor could not process enough cheese to meet the demand in western states.

Savings Available Through Direct Purchases of Ready-to-Use Products

In our May 1982 report on USDA's management of dairy products (GAO/CED-82-79, May 18, 1982), we concluded that USDA could save up to $1.4 million annually by buying all of its requirements for 1-pound packages of butter direct from processors rather than buying bulk products and repackaging them. Recognizing the need to rotate aged stock to minimize spoilage, we recommended that USDA evaluate its butter inventories each quarter to determine the amount such purchases could be increased. USDA now purchases some of its requirements for ready-to-use products direct but, as discussed below, the proportion of such purchases in relation to total purchases under the price-support program is small.

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Since our May 1982 report, ASCS has begun purchasing 1-pound butter packages direct. For example, in calendar year 1984, ASCS purchased about 36 million pounds of 1-pound butter packages (prints), or about 18 percent of the 206 million pounds of butter purchased under the price-support program. Also, about 13 percent of the 478 million pounds of cheese and 4 percent of the 677 million pounds of nonfat dry milk purchased under the program were in ready-to-use form.

In an August 30, 1984, letter to the Chairman, House Committee on Agriculture, on this issue, the Deputy Secretary of Agriculture stated that as needs occur, ASCS decides whether to convert bulk products into ready-to-use form or to purchase these products directly. Also, he said that as more of the bulk products are used, ASCS will be in a better position to purchase more products in ready-to-use form.

According to the Director of ASCS' Dairy Division, he is responsible for determining the quantities of products to be purchased in ready-to-use form. The Director makes the initial decision based on his analysis of dairy stocks and data on FNS' expectations of needs for the commodity donation programs. He then discusses his decision with the Deputy Administrator of ASCS' Commodity Operations, and a final decision is reached.

According to the Director, there are no written policies or procedures to follow in arriving at decisions, and nothing is written to explain the basis for the decisions reached. He explained, however, some of the factors that are considered in the decisions. One of the most important is minimizing spoilage. This requires reprocessing some of the older bulk products for use in the donation programs and buying products in bulk form because bulk products store better than do products packaged in consumer sizes. Another consideration is the processors' ability to provide products in ready-to-use form.

USDA also raised concerns about spoilage in commenting on the timing of implementing the recommendations in our May 1982 report. We said that while we recognized the need to rotate aging butter stocks, USDA could buy butter in 1-pound packages and still rotate its older stock until the 1-pound butter inventory reached the optimum level needed to fill projected requirements.

Conclusions

ASCS' inventory management system used to control the receipt, disposal, and inventory of billions of pounds of CCC-owned dairy products

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appears adequate to ensure that the products stored in public warehouses are properly accounted for and cared for. Further, our limited tests of the storage and movement of dairy products indicated that the selection of storage sites for newly acquired products appeared reasonable and that action was taken to limit the use of high-cost warehouses. In addition, our tests of the selection of products to ship to processors and recipients indicated that the decisions made were generally reasonable considering the geographical distances of the shipments.

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FNS Needs to Ensure That State Inventory Management Systems Are Properly Designed and Implemented

Under TEFAP, over $2 billion worth of dairy and other surplus products have been provided through state and local agencies to large numbers of poor and unemployed people. Moreover, the program has helped reduce the large inventories of CCC-owned dairy products, thereby holding down storage costs and enabling USDA to rotate stocks to help minimize spoilage. We found, however, that the inventory management systems used by the four states we visited needed to be improved to assure that products are properly accounted for and efficiently managed.

For example, of the four states visited,

- two (California and Pennsylvania) did not verify that all products ordered from FNS were received;
- one (Pennsylvania) did not have accurate and complete information on the TEFAP products it stored in public warehouses; and
- four were not adequately overseeing the local agencies' recordkeeping systems because they (1) had not evaluated the local agencies' systems (California, Michigan, and Pennsylvania) and (2) either were not reviewing the local agencies' monthly inventory reports (California) or requiring the agencies to submit such reports (New York and Pennsylvania).

These and other problems we found in each of the four states are discussed in detail later in this chapter.

Most of the problems we identified with state and local agency controls over TEFAP products dealt with the implementation of established procedures rather than with the design of the systems. Many FNS and state officials we talked with cited the program's temporary nature as the primary reason adequate inventory management systems were not always developed and/or properly implemented.

Although FNS has taken and is taking actions to improve state oversight of local agency recordkeeping systems, it needs to improve its own monitoring of state inventory management systems. FNS now requires that, starting with fiscal year 1985, the states periodically evaluate local agency systems. Also, FNS has issued proposed regulations that, when implemented, will require local agencies to, at a minimum, record the name and address of program participants and basis for eligibility. FNS, however, does not require its regional offices to periodically evaluate states' programs as it requires them to evaluate other donation programs. Although three of the four regional offices we visited had evaluated some state programs, the resulting reports were not always

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detailed enough to provide management with the information needed to make judgments about the adequacy of the states' systems. Moreover, only one of the four regional offices reviewed state inventory reports to monitor inventory levels.

FNS Requires State and Local Agencies to Maintain Accurate and Complete Inventory Records

After TEFAP was formalized by Public Law 98-8 in March 1983, FNS issued interim rules on April 26, 1983, that state, among other things, that USDA would make commodities available in accordance with part 250 of its regulations, which govern the traditional FNS commodity distribution programs. Interim rules FNS issued on December 16, 1983, after TEFAP was extended through fiscal year 1985 by Public Law 98-92, have a similar requirement. Section 250.6(r) of FNS regulations requires that state and local agencies, as well as commercial firms used to process surplus foods, maintain accurate and complete records with respect to the receipt, disposal, and inventory of donated foods and that local agencies keep accurate and complete records on the number of persons served.

Also, a proposed rule published by FNS on July 2, 1984, when finalized,[1] will require each local agency to keep accurate and complete records showing the data and method used to determine the number of eligible households the agency serves and, at a minimum, to collect and retain for each household participating in the program the participant's name and address and the basis for eligibility. According to FNS, the recording of this information will enable the state to gain a more accurate account of the number of persons served and aid the state in monitoring compliance with program requirements. The rule will also require that each state agency report to the appropriate FNS regional office the number of persons served and the amount of each commodity distributed within the state each month.

Implementation of State Systems Needed Improvement

Generally, the four states we reviewed had designed systems that could provide assurance that TEFAP products were properly controlled; however, the systems were not always implemented as designed. The state agencies administering TEFAP also administered FNS' traditional food distribution programs and, hence, had experience with managing donated products. For the most part, however, the agencies had to manage TEFAP without additional staff resources. This factor, along with the program's

[1]The proposed rule had not been finalized as of September 1985.

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temporary and voluntary nature, contributed to implementation problems. The states either had taken or were taking actions to correct most of the problems we found.

The results of our review of the inventory management systems used by the four states, with the two states we reviewed in depth (Michigan and Pennsylvania) discussed first, are described in detail below.

Michigan's Inventory Management System Is Adequate, but Local Agencies Did Not Submit Required Inventory Reports

Michigan's inventory management system properly accounts for products under state control. Before April 1984, however, the state did not ensure that products provided to local agencies were adequately controlled. Beginning in April 1984 Michigan made a number of improvements to better control TEFAP products made available to local agencies. The revised system, if properly implemented, should provide adequate control over TEFAP products. Although Michigan required local agencies to provide it with monthly inventory reports, as of the time of our fieldwork, most local agencies had not submitted these reports.

Michigan's Department of Education administers the state's TEFAP. In June 1984 the Department's office responsible for administering distribution programs had a staff of six people, two of whom were assigned to TEFAP full-time. The Department had written agreements with 34 local agencies, called community services agencies, which distribute the products through a number of distribution sites throughout the state. The state stored TEFAP products it received from USDA in six commercial warehouses. Two of the 34 local agencies had their own warehouses and received products directly from USDA.

System to Account for Products Under State Control Is Adequate in Michigan

Michigan's system for accounting for products under state control appeared to be designed and implemented properly. The Department of Education requires each commercial warehouse to maintain detailed records on the receipt, disposal, and inventory of TEFAP products. Although the agency does not maintain its own perpetual inventory records, it has procedures to check the accuracy of inventory records the warehouses maintain.

Pursuant to contracts with the state, each of the six commercial warehouses must, among other things,

- maintain true and accurate records on all transactions relating to the receipt, disposal, and inventory of products and

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- submit a delivery receipt form (SM-214) to the state agency within 7 days of arrival of products from USDA.

To account for products shipped to local agencies, the warehouses are required to provide the state agency with a shipping receipt (SS-4221) signed by a local agency representative acknowledging receipt of the products.

The warehouses are to prepare monthly inventory reports to show the book inventory balance and the physical inventory count with explanations of any differences between the two. When the inventory reports are received, the state agency verifies their accuracy. This is done by having one staff member compare the quantities of products shown on the reports as received and shipped with data maintained by a second staff member based on information shown on the delivery and shipping receipts (SM-214 and SS-4221) received from the warehouses.

Also, state agency staff periodically examined the commercial warehouses to, among other things, determine the adequacy of inventory records and storage conditions. Our review of the warehouse examination report file showed that the state agency had examined each warehouse from one to four times during fiscal year 1984. The most recent reports available showed that the examiners had not found any major problems with the warehouses' inventory records and storage facilities.

As discussed below, our review showed that the state agency had implemented the system in accordance with its procedures.

Our review of the agency's files showed that the warehouses had submitted all monthly inventory reports for the 6 months ended June 30, 1984. Also, we determined that the agency had a signed delivery receipt (SM-214) from the warehouses for each of 31 orders for TEFAP products that the state agency had placed with FNS during the 3 months ended March 31, 1984.

FNS' Midwest Regional Office also had a system designed to assure that Michigan and the other states in its region received all products they ordered. The Midwest Regional Office required each state to submit a monthly list of all deliveries as well as a monthly inventory report. Regional staff were to compare the states' delivery lists with information contained on FNS product delivery forms to determine whether all products ordered by the states were received. The staff were to follow up on any open orders to determine why they were open.

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In further testing implementation of the state's system, we reviewed the records of one of the six warehouses on the receipt and shipment of cheese products for the 3 months ended March 31, 1984. Our review showed that the warehouse

- had provided the state with a copy of all delivery receipt forms (SM-214) and had properly recorded the deliveries in its records;
- had obtained signed shipping receipts (SS-4221) for all shipments, provided the state with a copy of all shipping receipts, and properly recorded the shipments in its records; and
- accurately reported the quantities of cheese products received and shipped in each of the three monthly inventory reports submitted to the state.

Local Agencies Did Not Submit Required Inventory Reports to the State

Since the spring of 1984, when USDA's OIG investigated inventory problems experienced by the city of Detroit under the title I food distribution program, the Department of Education has taken a number of actions to improve the system used to ensure that local agencies properly manage inventories of both title I and TEFAP products. One of the actions was to require that the local agencies submit monthly inventory reports to the state. At the time of our fieldwork, the state's files contained reports from only about half the local agencies. When we followed up on this matter, an agency official told us that this problem had been corrected. (See p. 62.)

In its April 18, 1984, report (Audit No. 2702-9-Ch), the OIG stated that Detroit ordered title I commodities in excess of its needs and did not provide adequate warehousing for the commodities received. As a result, Detroit discarded about $278,700 worth of food that had spoiled and could not account for another $139,600 worth of food, a total of about $418,300. Also, the OIG said that at the time of its audit, Detroit had about $1.3 million worth of title I food on hand which represented a 2.2-year supply. The OIG concluded that while Detroit was primarily responsible for the losses, the state agency did not properly control inventory levels nor act when it became aware of reported losses. In accordance with FNS procedures, a claim for reimbursement, which may be in the form of commodities or money, was filed against the city. According to the Department of Education, the claim against Detroit was closed earlier this year when local food and cash donations were acknowledged as full replacement of the food loss. (See app. II.)

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During a March 1984 interview with OIG officials, the state agency program coordinator said that the state agency had not

- issued guidelines for the local agencies to follow in operating the program;
- evaluated the local agencies' operations nor inspected their warehouses;
- entered into written agreements with the local agencies; or
- required the local agencies to provide the state with any type of operating reports, such as reports on the receipt, disposal, and inventory of products.

As discussed below, the state has taken action on all of the above matters.

In April and May 1984, the state agency provided the local agencies with a copy of the state's TEFAP operating plan and asked the agencies to sign a written agreement to distribute TEFAP products, which all signed. The plan and agreement set forth, among other things, the state and local agencies' program responsibilities and the requirements and procedures to be followed for recordkeeping, reporting, and monitoring. In June 1984 the state agency also sent the local agencies a series of memorandums providing additional guidance on program requirements, procedures, and operations. Further, as discussed later, state agency personnel visited the agencies to review their storage facilities.

The state agency instituted a requirement that each local agency submit monthly inventory reports to the state showing product receipts, disposals, and inventory. The first reports required were to cover activity for the month of April 1984. However, as of July 1984, the state agency's files contained reports from only 19 of the 34 agencies for April 1984 and 17 for May 1984. The state agency is to use these reports to, among other things, determine whether the local agencies have excessive quantities of products on hand. Accordingly, these reports are important to the state's monitoring efforts.

State Comments and Our Evaluation

In commenting on pertinent draft sections of this report (see app. II), the state's Department of Education said that it concurred in most of the findings and that the report presents a fair picture of Michigan's program operations as they existed in mid-1984. The Department said that it wished to make clear, however, that the implementation of the inventory reporting system and the on-site reviews of local agency operations had only a coincidental relationship to the food loss in Detroit. It said

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that the reporting system and the reviews would have been pursued regardless of the food loss.

The Department said that as the program evolved, its reporting and monitoring practices had improved. It also noted that TEFAP is not financially self-supporting but instead relies heavily on donated space to conduct the distributions, on volunteers' time, and on funds from local and other sources.

The Department also said that USDA's claim against Detroit for the food loss was closed, and it identified several aspects of local agency operations on which the state's mid-1984 on-site visits were focused. The report has been revised to include this information. (See pp. 38 and 62.)

Pennsylvania's Inventory Management System Was Inadequately Implemented, but Improvements Were Being Made

Pennsylvania's inventory management system, as implemented, did not provide for adequate accountability over TEFAP products at the state and local levels. Our findings, in summary, are as follows:

- Regarding products controlled at the state level, we found that (1) the state's system to account for its orders and receipts of TEFAP products, while generally adequate in design, had not been implemented in accordance with state procedures, (2) the state did not properly account for bulk products sent to a commercial firm for processing into ready-to-use form, and (3) perpetual inventory records were not always properly maintained, and required physical inventories were not always taken.
- The state was not following FNS procedures governing the control of spoiled products.
- The state had no assurance that the local agencies had properly accounted for the receipt, disposal, and inventory of products because the state had not evaluated most of the agencies' recordkeeping systems and did not require periodic inventory reports from the agencies.

State inspection reports, however, showed that the condition of warehouses used to store TEFAP products was generally satisfactory.

State officials told us in January and March 1985 that actions had been and were being taken to deal with nearly all the problems. These actions included revisions to and automation of the inventory management system.

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Pennsylvania's Department of Agriculture administers the state's TEFAP. In September 1984, the Department's office responsible for administering distribution programs had a staff of 25 people, none of whom were assigned to TEFAP full-time.

The Department had a written agreement with each of the 67 Pennsylvania county governments governing TEFAP operations. Each county in turn had a similar agreement with a public or nonprofit agency to administer the county program. Before January 1984, the state had agreements with local administering agencies but, because of problems experienced, it revised its program to work through the county governments. The local administering agencies, along with local public and nonprofit agencies, distribute the food to program participants.

At the time of our fieldwork, the state was divided into eight regions. The state agency had contracts with 10 commercial warehouses to store USDA-donated products (two regions each had 2 warehouses, and six regions each had 1). The state agency had assigned each region a staff member, called a subdistribution agent, whose duties included maintaining inventory records for state products stored in the warehouses.

Pennsylvania Had Not Properly Accounted for Products Under State Control

The state's system for reconciling product orders with receipts had not been implemented effectively. As a result, the state had no assurance that all products ordered from FNS were received.

Under its system for controlling product orders and receipts, the state agency maintains a ledger in which information is to be recorded on orders placed with FNS and on deliveries made to the warehouses when the orders are filled. The state agency is to obtain documentation on product deliveries from either its subdistribution agents or the warehouses. State agency personnel are to review the ledger for orders that, based on scheduled delivery dates, should have been filled and, for any open orders found, contact the FNS regional office to determine the orders' status.

The product control ledger was not properly maintained. In reviewing the ledger, we found some cases where data from receipt documents were not posted until several months after the products were delivered to the warehouses. Also, as of June 1984, the ledger showed open delivery orders for 14 truckloads of cheese scheduled for delivery between September 1983 and January 1984 with no indication in the records that

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agency personnel had followed up with FNS. Thus, the agency had no assurance that all products ordered were received at the warehouses.

In discussing our review results with state agency officials in January 1985, we expressed concern about the ineffective implementation of the state agency's procedures to assure that all products ordered are received. The officials acknowledged the problem and told us that the individual responsible for the ledger at the time of our review had been replaced by a full-time employee who was posting data in a timely manner. Also, they said that the agency planned to automate the system in the near future.

In commenting on pertinent sections of our draft report (see app. III), the state's Department of Agriculture said that, due to the temporary nature of the program and its policy to maximize the use of limited funds for local agency operations, the Department used part-time rather than full-time staff. It said that through this method, 94 percent of Pennsylvania's fund authorization went to local agencies. Also, the Department said that according to its current records, the state ordered 318 truckloads of cheese during the period September 1983 to January 1984 and that 300 truckloads were received and 18 were canceled. It said that all commodities with delivery order numbers are accounted for in the state.

The state agency also had not properly accounted for about 3.8 million pounds of bulk cheddar cheese sent to two commercial firms for processing into ready-to-use form. It had no delivery receipt documents for the cheese, and its records accounting for the cheese after it was processed and shipped to the warehouses were incomplete. Using available records, we were able to account for all but about 190,000 pounds of bulk cheese. A portion of the 190,000 pounds of cheese we could not account for could be due to trimming losses during processing that, according to an AMS official, are generally less than 1 percent. According to the state's Department of Agriculture, the state recovered about $32,000 for the salvage value of the trim resulting from the cutting operation. (See app. III.)

Further, in a March 1984 report resulting from a review of the state's commodity donation programs,[2] USDA's OIG concluded that the state agency's monitoring of processors' operations was weak. It said that its

[2]Food and Nutrition Service, Food Distribution Program, State of Pennsylvania Department of Agriculture (Audit Report No. 27002-18-Hy).

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review at the state agency and at seven processing firms the state used showed that the agency, among other things, did not perform annual compliance reviews of all processors' operations, monitor processors' inventories of donated foods, and review processors' monthly performance reports. In commenting on the report, the state cited a number of actions taken in response to OIG's recommendations.

The state agency's system for controlling products stored in the commercial warehouses had not been implemented as designed. As a result, the state agency did not have accurate and complete inventory data, and products stored in the warehouses were not adequately controlled.

Since January 1984, the state agency had required its subdistribution agents to maintain separate perpetual inventory records for TEFAP products stored in each of the 10 warehouses and to perform monthly physical inventories. The agents were to submit monthly inventory reports to the state agency, which was to use the reports to determine the quantities of products available for offering to the local agencies.

Our review of the state agency's file of inventory reports for January to June 1984 showed that inventory reports were not obtained for two warehouses for 5 of the 6 months (February through June). According to state officials, this occurred because the subdistribution agent responsible for maintaining the inventory records at the two warehouses was on sick leave and his position was left vacant. During that time, the state agency relied on the warehouses to provide it data on the quantities of products available for distribution and to properly account for the products stored in the warehouses. Also, inventory reports had not always been obtained for five of the other eight warehouses; one or two reports were not obtained for each of the five warehouses.

Also, the reports that the subdistribution agents had submitted contained a number of arithmetic errors. We found examples where beginning inventories shown on a report for one month were different than the ending inventories on the preceding month's report with no explanation for the differences. The most significant arithmetic error we found was an understatement of 10,510 cases of processed cheese for the February ending inventory that was carried through to the June report. As a result, agency personnel were unaware that the cheese was available for distribution to the counties.

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In discussing our review results with agency officials in January 1985, we learned that they were unaware of the error. The officials said, however, that in implementing the revised warehousing system, complete physical inventories were taken at each warehouse that would uncover errors such as that discussed above. Also, in a March 13, 1985, letter, the program director told us that the situation at the warehouse in question was under control, and he provided us with a report of a February 1985 physical inventory. Moreover, he said that the agency now had a computerized inventory system that would rectify this type of problem.

We also found that the subdistribution agents' reports were not prepared on a consistent basis. For example, although state agency guidelines for maintaining perpetual inventories provided that issues (reductions in inventory) should be based on the quantities of products offered to and accepted by the local agencies, one subdistribution agent we talked with, who had responsibility for two warehouses, was basing issues on actual shipments out of the warehouses. There were also inconsistencies in calculating ending balances; on one report, several different methods were used to calculate the inventories for the various types of products listed.

Two subdistribution agents we talked with[3] were not making physical inventories in accordance with state agency requirements. One agent told us that he had never taken a physical inventory because, among other things, he was not aware that monthly physical inventories were required. Further, the warehouse operations manager told us that the warehouse took no physical inventories.

The second agent we talked with, who had responsibility for two warehouses, told us that she had stopped taking physical inventories at one warehouse because she could not readily determine which products belonged to the state. She also complained about the inadequate cooperation she received from the warehouse employees in trying to take physical inventories. In trying to reconcile the agent's book inventory with the warehouse's book inventory for the July 31, 1984, ending balances of processed and cheddar cheese, we found that the agent's records differed from the warehouse's records—1,550 cases under for processed cheese and 1,469 cases over for cheddar cheese. We did not discuss the procedures this agent followed at the second warehouse because only small quantities of TEFAP products were stored there.

[3]We also talked with a third agent during the initial phase of our review to obtain background information on how the warehousing system operated.

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USDA's OIG found similar problems with the subdistribution agents' procedures. In its March 1984 report, the OIG said that its review of the procedures three subdistribution agents followed showed that the state had not implemented needed internal controls over inventories of donated foods at the subdistribution agents' level because, in summary, the agents did not

- maintain or accurately prepare perpetual inventory records,
- reconcile physical and book inventories to determine whether all stock was accounted for, and
- accurately prepare and timely submit inventory reports.

The OIG concluded that, as a result, the three subdistribution agents did not have internal controls that would identify a theft or loss of part of the $20 million of donated foods that "passed through" the agents during the 1982-83 school year. Further, it said that since the agents' inventory reports were inaccurate, the state agency, in turn, had reported inaccurate information to FNS.

Subsequent to the completion of our fieldwork, the state agency revised its inventory management system. Under the new system, the state agency has separate contracts with 7 commercial warehouses to store TEFAP products (rather than the 10 warehouses in which all donation program products were stored). The contracts, among other things, require the warehouses to maintain perpetual inventory records, submit periodic inventory reports to the state agency, and take annual physical inventories. According to agency officials, the subdistribution agents will no longer maintain inventory records.

Pennsylvania Had Not Notified FNS of Spoiled Products

The state agency had not notified FNS of spoiled products as required. As a result, FNS did not have the opportunity to determine who was responsible for the spoilage and whether the responsible party should reimburse USDA for the cost of the products or replace them.

Under FNS' procedures, claims are filed against responsible parties for improper distribution and loss of foods due to shortage, spoilage, damage, or fraud, and for loss due to excessive inventory after such donated foods are provided to the states. Determining whether a claim is to be established is the responsibility of either FNS headquarters, the appropriate FNS regional office, or the state, depending on the value of the products involved. The state may handle losses of $2,500 or less for

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products under local agency control and $250 or less for products under state control.

In March 1984, the state agency began maintaining files of local agencies' reports of spoilage. Our review of agency files showed that about $112,000 worth of butter and cheese had been reported as spoiled in March and April 1984, of which about $108,600 involved cheddar cheese. About $1,500 worth of butter and $18,500 worth of cheese were transferred to schools to be salvaged for use under the school lunch program; the remaining products, valued at $92,000, were disposed of.

According to the state agency's field representative, the state agency did not notify FNS of the above losses because the state agency did not consider such losses as subject to claims. He said that most losses involved cheddar cheese and that FNS was aware that such cheese had mold problems.

State agency officials agreed that products disposed of should have been reported to FNS. In March 1985, they told us that action had been taken to correct this problem, including the reporting of the March and April 1984 instances of spoilage discussed above.

Condition of Pennsylvania's Warehouses Generally Satisfactory

Reports prepared by state inspectors showed that the condition of warehouses was generally satisfactory. Pennsylvania law requires that all cold storage facilities be licensed by the state's Department of Agriculture. Before being issued a license, the facilities must be examined and approved by the Department's Bureau of Foods and Chemistry. Once approved and licensed, the warehouses are to be examined periodically by Bureau inspectors.

According to the latest available Bureau examination reports for the 10 commercial warehouses used to store TEFAP products, the warehouses were generally in good condition. Although the examiners found some problems at several of the warehouses, at only two were major problems noted—one warehouse was not maintaining proper temperatures, and another had structural building defects (damaged walls, leaking roof, and defective floors) and unkempt outer premises.

In addition to making its regular examinations, the Bureau made a special examination of the 10 warehouses in February 1984 at the state agency's request. The request followed reports of moldy cheese being distributed. On the basis of this special study, the Bureau reported on

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February 24, 1984, that moldy cheese was found but that, except for the lack of refrigeration at one warehouse, the warehouse facilities did not have any significant problems. In discussing the moldy cheese, the report said that packaging of the cheese—loose wrappings and small holes in the wrappings—appeared to cause the problem. Subsequently, on March 1, 1984, the state agency issued a memorandum to local agencies and others advising that some of the cheddar cheese stored in the warehouses (5 to 7 percent) was "out of condition" and should not be distributed to program participants.

Pennsylvania Needs to Improve Its Management of Local Agencies

The state had little assurance that local administering agencies had properly accounted for and managed TEFAP products because the state agency had not

- reviewed most agencies' operations at the time of our review and
- required the agencies to prepare and submit periodic inventory reports to the state. (See p. 62.)

Our review of three local agencies' inventory management practices showed that they did not have accurate and complete records on the receipt, disposal, and inventory of products because their recordkeeping systems were not properly implemented.

One local administering agency we visited established its recordkeeping system in April 1984. Under its system, the agency was to keep a record of deliveries to each distribution site and require a distribution site official to sign an acknowledgement of receipt of delivery. Each site was to maintain a commodity distribution log that would show, among other things, the types of products provided each participant. These logs were to be sent to the local administering agency after each distribution, and the agency was to summarize the data on quantities of products issued.

We found that the agency's recordkeeping system had not been implemented as designed. The agency had no summary information on the quantities of products distributed because it had not summarized the logs on product issuances. Our attempt to summarize the data for April 1984 was unsuccessful because, at the time of our visit in July 1984, distribution logs were not available for four distribution sites, and the local administering agency, which also distributed products, had no records on the quantities of products it had received or distributed. Even if the logs had been available, however, an accurate accounting of products distributed by the sites could not have been accomplished

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because the logs did not show the actual quantity of products distributed to each participant, and the quantities given to program participants varied.[4]

Because of the lack of adequate records of products handled by the sites, the agency cannot assure that the products are properly accounted for. For example, agency records showed that one site had received 252 loaves of cheese and issued the cheese to 88 recipients. Assuming that each recipient was given the usual amount of one loaf, 88 loaves were distributed and 164 were not. No record existed of the disposition of the remaining 164 loaves. An agency official could not explain what happened to the remaining loaves but said that she assumed they were sent to the local food bank.

Another local administering agency we visited generally had a system designed to control the receipt, disposal, and inventory of products at distribution sites, but not all products issued to the sites had been properly accounted for.

Our review of this agency's records of distributions for May and June 1984 showed that for May, 1.5 percent of the processed cheese and 4.3 percent of the butter provided the sites were unaccounted for and that for June, 7.2 percent of the processed cheese and 5.1 percent of the butter were unaccounted for. An agency official told us that when a distribution site does not account for all the products issued to it, the agency writes a letter to the appropriate official requesting payment for the unaccounted for products or additional documentation accounting for the products. This had not been done in all cases, however. Our review of agency files covering the May and June distributions showed that some sites with fairly substantial quantities of unaccounted for products were not sent such letters.

One of the reasons for differences in quantities received and distributed by the sites is that the distribution logs did not show the quantities given each participant. For example, an official of one site explained to the agency that the difference between the quantities received and distributed occurred because the names of participants who had others pick up products for them were not recorded on the commodity distribution log. Listing the participants' names in the logs is important because, since the quantities given each participant are not shown, the total

[4]We found that although the state agency had issued guidelines on the quantities of products to be distributed to program participants, not all sites followed the guidelines.

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quantity of a particular type of product distributed is calculated by multiplying the number of names listed on the log by the normal quantity of that product given each participant.

The third local agency we visited also had not properly implemented its recordkeeping system. Also, the agency, which had its own storage facilities, had large quantities of products on hand.

The agency began keeping perpetual inventory records in February 1984. We compared data shown in the book inventory with supporting documentation on receipts and issuances for butter, cheddar cheese, and processed cheese covering the period February through August 1984. Our review showed that the inventory data on receipts were accurate but those on issuances were not. Issuances per the book inventory were underreported by about 8 percent for butter, 5 percent for cheddar cheese, and 3 percent for processed cheese compared with supporting documentation. Even with adjustments for the above differences, however, we could not reconcile the perpetual inventory with the physical inventory count as of September 1, 1984.

Our comparison of the agency's inventory balances as of September 1, 1984, with usage during the period February through August 1984, showed that the agency had a 6.7-month supply of cheese and 4.7-month supply of butter. Further, we found that an estimated 500 cases of processed cheese were being stored in an unrefrigerated area of the agency's warehouse, apparently because there was no room for the cheese in refrigerated space. In discussing the large quantities of cheese and butter on hand, the agency director told us that the agency would not accept the state's next offering of products.

State Comments and Our Evaluation

In its comments dated August 22, 1985 (see app. III), the state's Department of Agriculture said that the draft report contained statements that were not directly applicable to current program conditions in Pennsylvania. Although our draft report contained information on the actions taken through early 1985 to improve the state's inventory management system, the Department provided more specific information on the actions taken. The Department said, among other things, that:

- The inventories for its seven warehouses were verified and put on its automated inventory system in January 1985.
- The state's warehouse contracts require the warehouses to submit monthly inventories on or before the 10th day of the following month,

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the warehouses' inventories are verified by the state and any necessary adjustments are made before the state's next allocation of commodities to the counties, and state personnel periodically verify the system.

- Perpetual inventories are now a warehouse responsibility but are subject to frequent verification by the state and at least one annual physical inventory.
- FNS procedures regarding control of spoiled products had been resolved.
- The state's ordering system had been computerized for the 1985-86 program year. The system will include sophisticated management information reporting to facilitate improved internal control and accountability.

We believe that the state's actions, if properly implemented, should provide adequate control over TEFAP products at the state level.

Regarding its management of local agencies' programs, the Department said that the agreement/contractual relationship with local agencies includes accountability for recordkeeping at the local level with review by federal and state agencies and that the state established a monitoring and review system for TEFAP beginning in fiscal year 1985. Also, the Department said that, in its opinion, the existing internal controls were acceptable at the local level commensurate with a temporary program with limited resources. The Department added that the report did not mention the substantial volunteer effort involved with its program.

As discussed on page 63, FNS has taken action to improve the states' monitoring of local agency programs, including inventory controls. Regarding local agencies' internal controls, our finding was that the recordkeeping systems used by the three local agencies we reviewed were not properly implemented; we did not question the adequacy of the systems' design. Although the sections of the draft report provided the state for comment did not refer to the volunteer effort in TEFAP, other sections of the report noted this effort as well as the benefits of the program.

The Department also commented on various matters relating to the scope of the review. Our responses to those comments are included in appendix III.

California's Inventory Management System Needs Improvement

California's inventory management system, as implemented, did not provide for adequate accountability over TEFAP products at the local level. In summary, we found that the state did not

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- ensure that products ordered from USDA were received by local agencies,
- review the adequacy of the local agencies' recordkeeping systems, or
- review the monthly inventory reports it required local agencies to submit to the state.

In addition, the state did not include TEFAP inventory data on the monthly reports submitted to the FNS regional office. At the time of our fieldwork, the state agency was in the process of providing the local agencies with additional guidance on program operations and hiring additional staff to carry out program review and management functions, including the preparation of the monthly inventory reports required by FNS.

California's Department of Education administers the state's TEFAP. In October 1984 the Department's office responsible for administering distribution programs did not have any personnel assigned to TEFAP full-time. Before June 1983 the state's Department of Food and Agriculture administered TEFAP.

The Department of Education had written agreements with 50 food banks[5] that administer the program in the state's 58 counties. These local agencies arrange for distributions at various sites throughout the state.

Most TEFAP products receive[d] from USDA (about 85 percent, according to a Department official) were delivered directly to the local administering agencies. The rest were delivered to commercial warehouses under contract with the state for subsequent delivery to the smaller local agencies that are not equipped to handle large quantities of products.

California's Inventory Management System

At the FNS Western Regional Office, we learned that the state agency, primarily for staffing reasons, did not summarize and include TEFAP data on the monthly inventory reports (FNS-155) submitted to the region on FNS distribution programs. FNS needs this information to ensure that the states do not have excessive inventories of products on hand. The chief of the state's distribution program told us that 10 new people were

[5]According to state agency officials, although referred to as "food banks," the vast majority are not true food banks but instead are volunteer community action type agencies, such as economic opportunity commissions, community services agencies, and senior citizen agencies.

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to be hired and, when they were, the agency would prepare an inventory report covering the entire period the agency had administered the program (June 1983 through October 1984).

The state agency had not determined whether all products it ordered from USDA were received. Pursuant to their agreements with the state, the local agencies are required to notify the state of all products received; however, according to state agency officials, the agencies did not always comply with the requirement. Officials of the state agency and the three local agencies we visited told us that one reason for the lack of notification was that the trucking firms delivering the products did not always give the local agencies a copy of the bill of lading, which, in turn, is to be sent to the state agency.

Our review of the state agency's files showed that, as of November 2, 1984, the state had received signed bills of lading for only 64 (22 percent) of the 293 delivery orders submitted to FNS during the last quarter of fiscal year 1984. State agency officials told us that the agency would follow up with the local agencies to obtain the required documentation after the new staff were hired.

The agreements between the state and the local agencies require that the local agencies maintain records on the receipt, disposal, and inventory of products and that the local agencies provide the state agency with monthly inventory reports. Although state agency personnel had obtained information on the local agencies' recordkeeping systems during visits to the agencies, the state agency had not evaluated the systems. Further, state agency officials told us that monthly inventory reports received from the local agencies were filed without review.

According to the state's fiscal year 1985 operating plan, state agency personnel would evaluate each local agency's program at least once every 6 months. The plan states that the evaluations will include a review of each agency's inventory records to ensure that all transactions are properly recorded. Further, the state agency's Deputy Chief Surplus Property Officer told us that one of the new staff members hired would be assigned the responsibility of verifying the accuracy of the data on the local agencies' monthly inventory reports and use the reports to help manage the program. Also, at the time of our review, the state agency had drafted a program procedures manual containing detailed guidance on program operations, including inventory management procedures. Agency officials told us that the agency planned to

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hold a series of workshops with the local agencies, after the manual was issued, to explain the new procedures.

Information obtained from officials of the three local agencies we visited indicated that the agencies had reasonable recordkeeping systems. We did not determine, however, whether the systems had been adequately implemented.

State Comments and Our Evaluation

In commenting on pertinent draft sections of this report (see app. IV), the state's Department of Education said that it had moved forward to strengthen state and local management of TEFAP in accordance with USDA regulations and that it believed that the actions taken would correct the problems identified in our report. The Department said that, among other things:

- TEFAP data are now included in the monthly inventory reports submitted to FNS.
- Of 520 delivery orders issued for TEFAP products during the period July 1 through September 30, 1984, 412 had been confirmed, and follow-ups had been and were being made with local agencies to confirm the rest.
- The state agency had received authorization to hire additional staff, trained its field staff, issued the program procedures manual to the local agencies, and held the planned workshops.

We believe that these actions, if properly implemented, should correct the problems we found.

New York's Inventory Management System Needs Some Improvements

New York had a system designed properly to account for the receipt, disposal, and inventory of TEFAP products stored in state-leased warehouses but not for products it provided to local agencies. According to information obtained from the program director and the FNS regional office, many of the local agencies did not maintain accurate and complete records on the TEFAP products provided them.

New York's Office of General Services administers the state's TEFAP. In November 1984 the Office's agency responsible for administering distribution programs had 29 staff members, 8 of whom were assigned to TEFAP full-time.

For all areas except New York City, the state had written agreements with 100 local administering agencies that were designated by the

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county governments to administer the program within their counties. In New York City it had an agreement with the city's Human Resources Administration, which oversees about 700 organizations that distribute the food and/or have agreements with local public and nonprofit agencies to distribute the food.

At the time of our review, the state agency had contracts with 13 commercial warehouses, including 3 in New York City, to store the products. Each warehouse was required to maintain perpetual inventory records and to report end-of-month inventory balances to the state agency.

Accountability for Products Under State Control Appeared Adequate in New York

We obtained information from the director of New York's food donation program on the system the state used to account for the receipt, disposal, and inventory of products stored in state-leased warehouses. In summary, the state's system was to operate as follows:

- The state agency was to assure that all products ordered from FNS were received by maintaining a ledger in which orders submitted to FNS were to be posted and in which receipts were to be posted based on documentation the warehouses submitted. The ledger was to be reviewed periodically to determine whether there were open orders for which delivery should have been accomplished and, if so, appropriate follow-up was to be made with FNS.
- Warehouse issuances of products to the local agencies were to be controlled through a multiple copy form, referred to as a pick-up-slip. Once the quantity of products the state would make available to the local agencies was decided, the pick-up-slip was to be prepared by the state agency, and copies sent to the appropriate warehouses and local agencies. When products were picked up from a warehouse, a representative from the local agencies was to sign the pick-up-slip, and the warehouse was to submit the receipted copy to the state agency.
- Each warehouse was required to submit monthly inventory reports to the state. State personnel were to verify that beginning balances agreed with the preceding month's ending balance and that the quantity of products shown as received agreed with supporting receipt documentation. State agency personnel were to take complete physical inventories

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annually and make unannounced monthly visits to take partial inventories. The state agency required the warehouses to reimburse the state for any shortages found.

New York Needs to Improve Local Agencies' Recordkeeping Systems

The state had no assurance that local agencies were properly accounting for the receipt, disposal, and inventory of TEFAP products. The local agencies had not submitted inventory reports, and many agencies had not maintained summary information on products distributed, a prerequisite to preparing inventory reports.

According to the donation program director, the state agency had not provided the local agencies with any written guidance on establishing recordkeeping systems. However, the state and local agency agreement stated that the local agencies must maintain records to document the receipt, distribution, and inventory of products. Our discussions with the donation program director and officials of a local agency, as well as the results of FNS field office reviews of New York agencies, indicated that many agencies were not maintaining inventory records.

According to the director, the usual problems noted by state personnel during their monitoring visits to local agencies were that products were improperly stored and that distribution records were not maintained. Also, for New York City, which accounted for about 60 percent of all TEFAP products distributed in the state, no summaries existed of the quantities of products distributed or the number of people served. The director said that because of the huge volume of products distributed, summarizing this information would be an impossible task.

The local agency we visited also did not maintain summary information on the quantity of products distributed. The agency distributed TEFAP products itself and had agreements with three other organizations that distributed products in the county. According to agency officials, no perpetual inventories were kept, and no summarization was made of the quantities of products distributed. The officials were unable to tell us whether the three other organizations summarized distribution data. According to the officials, the agencies had historically distributed all products provided them or returned undistributed products to the agency for storage. The agency had summarized information on the number of participants it served.

FNS field office evaluations of local agencies also showed that many New York agencies distributing food under TEFAP and the title I program had

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not maintained adequate records. In a July 23, 1984, memorandum summarizing the results of its field office evaluations, the FNS Northeast Regional Office stated that of about 300 local agencies reviewed, 46 were determined to have inadequate records and that 44 of the 46 agencies were located in New York. The memorandum did not segregate the agencies by program.

State Comments and Our Evaluation

In commenting on pertinent draft sections of this report (see app. V), the state's Office of General Services said that throughout TEFAP's 2-year life, USDA had not provided either written or oral directions regarding the specific types of records that must be maintained at the local level. The Office said that in the absence of specific directions, it had informed all local organizations of the general requirement that records connected with the distribution of donated foods must be created and retained as evidence of distribution activities.

The Office added that its field staff had visited each distribution site in the state and that each site had been provided guidance on recordkeeping requirements. It said that if TEFAP was extended beyond September 30, 1985, its staff would continue to work with local agencies to ensure that adequate records are maintained.

The Office also said that it had attempted to ensure that administrative procedures were adequate to establish accountability but did nothing to detract from the primary purpose of getting TEFAP products to the needy in a timely and effective manner. It added that, to this end, the requirements placed on local organizations had been minimized. The Office did not comment on the need for local agencies to prepare and provide it with periodic inventory reports. We believe that such reports are needed to help ensure that TEFAP products are properly managed by the local agencies.

The Office also cited TEFAP's benefits, saying that since TEFAP began in late 1983, more than 100 million pounds of donated foods had been provided to the state's needy with the help of volunteer organizations and citizens.

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Monitoring of Inventory Management Systems Used by State and Local Agencies Needs Improvement

FNS requires its regional offices to evaluate other FNS commodity donation programs, such as the school lunch program, but does not require them to evaluate the states' implementation of TEFAPs. Although three of the four regional offices we visited made evaluations of some state TEFAPs, the evaluation reports prepared by the three regions did not always present the information needed for management to determine whether the evaluation was adequate and/or if the states' inventory management systems were properly designed and implemented. Moreover, three of the four regional offices did not review state inventory reports to determine whether the states had excessive inventory levels. As a result, one of the states we visited had more inventories than it could reasonably distribute—some of which had spoiled.

At the time of our review, only one of the four states visited had established a formal program to periodically evaluate the local agencies' programs. Further, two states did not require periodic inventory reports, and the other two states had either not reviewed or not obtained the required reports. Beginning in fiscal year 1985, FNS required the states to evaluate local agency programs periodically; and it proposes to require that states obtain periodic inventory reports from the local agencies. Action is needed, however, to improve FNS' oversight of the states' programs and ensure that the states properly carry out their inventory control programs and implement the new FNS requirements.

FNS Should Require Regional Office Evaluations of State Inventory Management Systems

Of the four regional offices visited, one (the Northeast Regional Office) had not evaluated the administration of state TEFAPs. Northeast Regional Office officials told us that the region did not make periodic evaluations because (1) FNS regulations do not require them and (2) the region did not have the staff resources needed to make such evaluations. The other three regional offices visited had evaluated the administration of all or nearly all of their states' programs in fiscal year 1984, often in conjunction with the FNS-required annual evaluations of traditional donation programs.

The Mid-Atlantic Regional Office had evaluated all state programs in its region in fiscal year 1984. The Midwest Regional Office had evaluated four of the six states in its region. According to regional officials, one state (Michigan) was not evaluated because the OIG was reviewing the program, and the other state (Indiana) was not evaluated because an evaluation was done in the latter part of fiscal year 1983. The Western Regional Office had evaluated five of the seven participating states in its region. According to regional officials, one state (California) was not

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evaluated because the OIG and a state-hired consultant firm were reviewing the program, and one state (Hawaii) was not evaluated because of a shortage of travel funds.

Our review of the evaluation reports and discussions with FNS regional officials indicated that the regional offices' evaluations were generally comprehensive in their coverage and inventory management matters. Some reports, however, would have been of limited use to FNS management officials in assessing whether the states' inventory management systems complied with FNS requirements. This is primarily because the reports were not always clear about what work the evaluator had done, particularly in determining how well the systems were being implemented, to arrive at the conclusions reached.

For example, a Western Regional Office evaluation of both TEFAP and the title I program administered by Idaho resulted in a one-page report, with a brief paragraph describing the evaluator's conclusions and/or findings on each program. On TEFAP, the report stated that the program was operating at a high level of accountability but said little about how or why this conclusion was reached.

Further, although the reports often described the states' inventory management systems, it was not always clear whether the systems were adequately implemented. For example, the evaluation of Pennsylvania's program, the only state we visited that had been evaluated as of the time of our fieldwork, described the state's system accounting for products under state control but did not discuss the system's implementation. As discussed on pages 40 to 45, we found that implementation was not adequate. Therefore, reading the evaluation report could have led to a conclusion that the state had an adequate inventory management system when it did not.

FNS Field Offices Evaluate Local Agency Programs

Although FNS does not require its regional offices to evaluate state TEFAPs, it does require the regional offices' field offices to evaluate local agency TEFAPs.

To ensure that local agencies were adhering to title I and title II program guidelines and criteria, particularly in regard to product accountability, FNS directed its regional offices in July 1983 to have each of their field offices, of which there were 78 as of December 1984, review at least one

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food bank and one soup kitchen each month.[6] These evaluations, which show the types and extent of problems occurring at the local level, can be useful to management in assessing how well the states are administering their programs.

For example, in a June 28, 1984, memorandum to the regional offices, the Director of FNS' Food Distribution Division stated that the field office reviews during the prior year showed that two areas appeared to be serious problems in at least four of the seven regions—accountability for and storage of commodities. The specific items the Director cited as problems are listed below:

Accountability for Commodities:

- Lack of accountability for commodities that are transferred between locations.
- Inaccurate or missing issuance records.
- Inadequate food usage records.
- Variances between physical inventories and book inventories.
- Incomplete and missing distribution rosters.
- No perpetual inventory records.

Storage of Commodities:

- Signs of insect and rodent infestation in storage areas.
- Excessive inventory.
- Inadequate temperature controls in freezers and missing thermometers.
- Foods not stored (off the floor) on pallets.

As discussed above, FNS evaluations of local agency programs are useful; however, if a regional office does not have enough staff resources to evaluate both state and local programs, as apparently occurred in the Northeast Regional Office, we believe that priority should be given to evaluating the states' programs. This is because a well-administered state program could help minimize problems at the local level and because, as discussed later, FNS now requires the states to evaluate local programs.

[6]Food banks would generally be involved in TEFAP (title II), while soup kitchens would generally be involved in the title I program.

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FNS Regional Offices Need to Review State Inventory Reports to Monitor Inventory Levels

FNS requires the states to provide it with monthly inventory reports to, among other things, ensure that the states' inventory levels are not excessive in relation to normal usage of products. However, of the four regional offices we visited, only the Midwest Regional Office reviewed the required reports to determine whether the states had excessive inventory buildups of TEFAP products.

Although all four regional offices received monthly inventory reports (FNS-155) on the states' food donation programs, the Mid-Atlantic and Northeast Regional Offices did not require the states in their regions to segregate the reported data by individual commodity program. Thus, it was impossible to tell the inventory levels of TEFAP commodities. Officials of these two regions cited this as the reason the reports were not used to monitor TEFAP inventory levels. Although the Western Regional Office required that data be reported by program, an official told us that the reports were filed without review because reviewing the reports was not considered a regional office responsibility. Moreover, as discussed previously, California did not include TEFAP inventory data on the reports.

Although Pennsylvania had much higher inventory levels on hand than New York, neither state segregated inventory data by program; accordingly, it cannot be determined whether Pennsylvania's TEFAP inventory levels were excessive considering normal usage. Using average monthly usage data covering all donation programs shown in the monthly inventory reports Pennsylvania submitted to the regional office for 12 of the 13 months ended May 31, 1984 (the December 1983 report was not available), we calculated that the state had about a 1-year supply of processed cheese and butter on hand as of May 31. In contrast, our review of the inventory and usage data covering all donation programs shown in New York's inventory reports for the 10 months ended July 31, 1984, showed that New York had about a 2-month supply of processed cheese and a 1.5-month supply of butter on hand as of July 31.

Because Michigan reported data by program, we were able to segregate Michigan's TEFAP data. Our review of the inventory of processed cheese as of June 1984 showed that the state had slightly over a 1-month supply.

Monitoring inventory levels is particularly important for TEFAP because inventory buildups can reduce FNS' effectiveness in minimizing displacement of commercial sales—a requirement of the act. Large inventories

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can create an incentive for a state and, in turn, a local agency to distribute greater quantities of products than they otherwise would. Although we did not determine the effect of high inventory levels on commercial displacement, we believe that such a situation could increase the displacement of commercial sales.[7]

One way FNS tries to minimize displacement is by controlling the quantities of products made available to states through its allocation system. However, when products FNS allocates to a state are refused, these products are reoffered to other states. Until July 1984, one of the four states we visited (Pennsylvania) accepted its full allocation plus all additional quantities FNS made available to it through reofferings. The state, in turn, provided some counties with substantially greater quantities of products than they would have received under the allocation formula used.

For example, during the 6 months ended June 30, 1984, counties within three of Pennsylvania's eight regions received from 20 to 60 percent more products than they were entitled to under the state's allocation formula (counties within the other regions generally received about the same or less). An official of one local agency in Pennsylvania, which administered distributions at over 40 sites, told us that the agency had based the quantities of products given to program participants on the quantities of products the state made available. This, he said, generally resulted in giving each participant 2 pounds of butter and 10 pounds of cheese, regardless of family size. These quantities were substantially above the state's guidelines, which provided that a family of two should receive 1 pound of butter and 5 pounds of cheese.

Regarding inventory buildups in Pennsylvania, state agency officials told us in July 1984 that the state would stop accepting products offered in excess of its normal TEFAP allocation because of the large inventory of products on hand and because the counties had rejected about 50 percent of their June 1984 allocations. Further, in a January 1985 meeting, state agency officials told us that the state agency had begun surveying the local agencies to determine their needs and that the survey data had been used in arriving at decisions about the quantities of TEFAP products to order from FNS. The state officials said that as a result of the first survey taken in late 1984, the agency had cancelled

[7]For a more detailed discussion of displacement, see our Mar. 14, 1984, report entitled Improved Administration of Special Surplus Dairy Product Distribution Program Needed (GAO/RCED-84-58).

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orders placed with FNS and that the quantities of products held in the warehouses had been reduced.

State Monitoring of Local Agencies Now Required

FNS began requiring that state agencies establish a monitoring system in fiscal year 1985. Although FNS did not require a state monitoring system prior to fiscal year 1985, one of the four states we visited (New York) had evaluated all local agencies' programs, including recordkeeping systems, through a formal program at the time of our fieldwork. Following is a brief description of each of the four states' monitoring efforts.

According to New York's donation program director, state personnel visited each local agency every other month to evaluate the administration of their programs, including recordkeeping systems. However, the state did not require the local agencies to provide it with periodic reports on the receipt, disposal, and inventory of TEFAP products.

Pennsylvania began visiting local agencies to evaluate the administration of their programs in March 1984. Through June 1984, the state had evaluated and reported on the administration of TEFAP by 15 local agencies and distribution sites (there are 67 local agencies and many more distribution sites). Also, the state agency did not require periodic inventory reports from local agencies. In January 1985, state officials told us that the state agency was expanding its evaluation efforts by shifting some staffing resources from the traditional donation programs.

According to Michigan distribution program officials, state personnel had visited the local agencies as part of a special one-time evaluation effort in the spring of 1984. This effort was made, in part, because of the problems in Detroit involving spoilage and disappearance of commodities under the title I program. In commenting on pertinent sections of the draft report (see app. II), the state's Department of Education said that the evaluations focused on multiple aspects of the local agencies' operations, including (1) recipient eligibility determination practices and procedures, (2) product tracking practices and procedures employed to account for products received and distributed, (3) adequacy of storage facilities, (4) rates of product issuances, and (5) recordkeeping. Although Michigan required periodic inventory reports from local agencies, only about half the agencies were complying with this requirement at the time of our fieldwork. In December 1984, however, a state official told us that all local agencies were submitting the required reports.

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According to California distribution program officials, state personnel had visited each local agency at least once, and most were visited twice, to obtain information on the agencies' operations and to provide them with technical assistance. The officials said that the local agencies' recordkeeping systems were not evaluated to determine whether program deficiencies existed. Although California required periodic inventory reports from local agencies, the reports were not being reviewed by state personnel.

In its August 14, 1985, comments (see app. IV), the state's Department of Education said that its field staff had nearly completed the first comprehensive reviews of all food banks and were in the process of writing their reports. The Department said that the reviews included evaluations of the food banks' inventory records and that, where deficiencies were observed, follow-ups were being made to assure corrective action.

To increase program accountability, on July 2, 1984, FNS published in the Federal Register a proposed rule that would, among other things, (1) add a new section to TEFAP regulations requiring each state distributing agency to establish and carry out a monitoring system that includes an annual review of emergency feeding organizations (local administering agencies) within the state and (2) require the states to obtain periodic inventory reports from local agencies. According to the proposed rule, the annual reviews would have to encompass an evaluation of

- eligibility determination procedures,
- commodity ordering procedures,
- storage and warehousing practices,
- inventory controls,
- procedures for approval of distribution sites, and
- compliance with reporting and recordkeeping requirements.

Further, each state would have to include in its annual TEFAP operating plan a description of the monitoring system established.

Although the proposed rule had not been finalized at the time, FNS advised its regional officials in August 1984 that the establishment of a monitoring system would be required for the states' fiscal year 1985 programs. Accordingly, beginning in fiscal year 1985, the states must review each local administering agency at least annually.

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Conclusions

Although, as discussed in chapter 2, USDA was doing a good job of implementing its inventory management system for dairy products under its control at public warehouses, FNS was not having similar success in assuring that state and local agencies in the four states we reviewed were properly implementing their inventory management systems. FNS and state officials attributed these shortcomings to the temporary and volunteer nature of the program and to uncertainties about its continuance.

Certain basic procedures common to good inventory management practices should be implemented in programs such as TEFAP to assure that products are properly accounted for and efficiently managed. These practices are included in USDA's implementation of its inventory system and, in fact, are a part of the other FNS commodity donation programs. These practices include, among other things, the use of perpetual inventories, accurate recordkeeping, periodic inventory reports to FNS management, and periodic monitoring of state and local inventory management practices.

We recognize that TEFAP was established as a temporary program and that its continuance has depended on periodic legislation. However, $2.3 billion worth of surplus products was distributed under the program through November 1984. This is a significant government investment that justifies the use of sound inventory practices.

Our review showed that while the four states we reviewed had designed inventory management systems that, if properly implemented, would have provided the necessary control to properly account for the receipt, disposal, and inventory of TEFAP products, some of these controls were not properly implemented. For example, two states did not verify that all products ordered were received, one did not properly maintain perpetual inventory records or take periodic physical inventories, three did not have a formal program to periodically monitor local agency recordkeeping systems, two did not require periodic local agency inventory reports, and one that did simply filed the reports without reviewing them. FNS and the states took or are taking actions to correct these problems. For example, FNS now requires the states to monitor local recordkeeping systems.

We believe that although these actions should improve the state and local agencies' recordkeeping systems, FNS needs to improve its oversight of the states' programs to better assure that the state and local agencies adequately implement their systems.

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FNS does not require its field offices to periodically evaluate the states' inventory management practices as it does for other commodity donation programs. Since such evaluation efforts are required for other FNS programs, a similar effort for TEFAP should not place undue burdens on regional staff, particularly if these evaluations are combined with evaluations of other programs, as we found was done in some cases. If, however, the regional offices do not have sufficient staff resources to carry out such a requirement, as we were told by Northeast Regional Office officials, we believe that staff resources currently being devoted to evaluating local agencies' programs could potentially be diverted to this effort. The new requirement for state evaluation efforts lessens the need for FNS local evaluation efforts that could be duplicative.

Further, even where FNS regional offices were voluntarily evaluating state programs—and we did not find anything wrong with the adequacy of these evaluations—the reports produced by these evaluations were not sufficiently detailed to provide FNS management with the information it needed to determine whether the states' inventory management systems were adequate.

Moreover, although FNS regional offices were receiving monthly inventory reports they could use to monitor inventory levels, only one of the four regions we reviewed was using the reports for this purpose. This occurred in two regions because the states did not report TEFAP data separately from other commodity programs. The third region simply did not use the reports. FNS should require the states to segregate data by program so that the reports can be used to determine the reasonableness of inventory levels.

Although we did not attempt to determine the extent of inventory losses occurring as a result of the weaknesses we found, failure to implement a sound inventory management system and to properly evaluate and monitor that system to assure it is working as designed can potentially lead to spoilage, loss of product, and a lack of assurance that the products are going to eligible participants. Requiring FNS field office evaluations of state efforts, along with detailed reports of the results of those evaluations and better use of the monthly inventory reports the regional offices are receiving, should place FNS in a much better position to avoid these potential consequences.

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Recommendations to the Secretary of Agriculture

We recommend that the Secretary of Agriculture direct the FNS Administrator to require the FNS regional offices to

- periodically evaluate and report on the states' inventory management systems to provide management with the information needed to determine whether the systems provide control over the receipt, disposal, and inventory of products at both the state and local levels and
- review the monthly inventory reports submitted to them by the states to ensure that data on TEFAP are reported and that inventory levels are related to normal usage.

Agency Comments and Our Evaluation

In commenting on a draft of this report (see app. VI), USDA said that it generally agreed with our recommendations. Regarding our recommendation that FNS regional offices periodically evaluate and report on the states' inventory management systems, USDA said that if TEFAP was extended past September 1985,[8] FNS would strengthen the standards for monitoring, reporting, and recordkeeping to improve program accountability. In explaining how this would be done, USDA said:

"The regulations will establish specific standards for States to use in monitoring program performance as well as specific recordkeeping and reporting requirements at the State and local levels. The monitoring component will include methods by which the States and in turn, the Department, have of assessing operational aspects of TEFAP. Feedback for monitoring activities will provide valuable information about the need for technical assistance at both the State and local levels. We will continue to use volunteers and will be careful that recordkeeping, monitoring, and reporting requirements are followed. However, we have also been mindful of the legislative requirements to minimize paperwork for State and local program cooperators."

Regarding our recommendation that FNS regional offices review the states' inventory reports, USDA said that FNS would monitor reports required of the states.

In its overall comments, USDA said that while FNS and GAO had reached the same basic conclusions, the draft report failed to acknowledge the developmental nature of the program. USDA said that when the program began in December 1981, no government infrastructure existed to accomplish distribution of commodities to households and therefore the

[8]The proposals in our draft report, which were contingent upon TEFAP's extension beyond September 1985, were revised in our final report because TEFAP has since been extended (see p. 11).

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program was designed to give maximum latitude to the states in identifying organizations willing to assist in this special effort. USDA said that the organizations that responded were mostly volunteer groups that understandably lacked the capability and resources to absorb major administrative requirements. To implement the program as quickly as possible, the states were given the responsibility of locating distribution outlets and administering their own programs.

Further, USDA said that based on the amounts of dairy products available and the program's popular support, the program has been extended but that the program has consistently been viewed as a temporary emergency program and, as such, FNS has been reluctant to encumber the program with elaborate rules, regulations, and requirements. Also, USDA said that because the program was extended and administrative funds were made available to states and local distribution outlets, the temporary and volunteer nature of the program had gradually changed. USDA added that since our review, and because commodities were likely to remain available for distribution, FNS had developed the regulations discussed above to strengthen program accountability.

This final report, like our draft report, describes in some detail TEFAP's evolution and its temporary and voluntary nature. USDA's comments provide an additional description of these matters.

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Forms Used to Control the Receipt, Disposal, and Inventory of CCC-Owned Dairy Products

Basic legislation directs USDA to support the price of milk for producers. Support is accomplished by offering to buy at announced prices all butter, cheese, and nonfat dry milk meeting USDA specifications and offered in carload quantities.	After offers are accepted, an eight-part shipping document is prepared showing what is to be shipped, the origin and destination, and when and how it is to be shipped. These documents become the primary control for adjusting inventory, assuring the products are received, and paying for the products and their transportation.	1. Two copies of the eight-part form are sent to the seller. The seller then ships the product as instructed and returns one copy to USDA as the invoice along with a bill of lading showing the product was shipped and a certificate showing the product's grade as determined by a USDA inspector. 2. One copy is sent to the Kansas City Commodity Office's Freight Settlement Branch and is used to match the freight bill and authorize freight payment. 3. One copy is sent to the USDA Settlement Branch and is matched with the copy returned by the seller as its invoice to authorize payment for the dairy products. 4. The remaining four copies are sent to the receiving warehouse. —Three copies are returned to USDA as warehouse receipts, one of which is used to match with the copy sent to the Settlement Branch to enter the quantity into inventory records, another to support any claims actions that may be necessary against the seller, and the third, for record purposes. —The final copy is retained by the warehouse for its records.
Requests for dairy product donations are submitted to the Kansas City Commodity Office. These requests set out such things as the type of product desired, quantity needed, and where it is to be delivered. KCCO staff use the information to subjectively select which warehouse or which processor is to ship the product. This decision is made following general policy requirements on such matters as transportation costs, the age of products in storage, and prospects for continued safe storage.	After shipping decisions are made, an eight-part shipping document is prepared showing what is to be shipped, the origin and destination, and when and how it is to be shipped. These documents then become the primary control for adjusting inventory, assuring the products are received, recording the transaction in the accounting records, and paying for transportation.	1. Two copies of the eight-part form are sent to the designated shipper. For all USDA Food and Nutrition Service commodity donations, such as TEFAP, a two-part Shipping Notification form and standard shipping instructions are sent to the shipper. Use of the Shipping Notification is discussed later. 2. One copy is sent to KCCO's Freight Settlement Branch and is compared with the freight bill when it is received. Necessary information is then entered into the payment system, and the freight bill is paid. 3. One copy is sent to ASCS' Fiscal Division at KCCO and is compared with another copy returned by the receiving agency as a receiving document. These two copies, along with the bill of lading and any report of shortages, overages, or damages, are then used to adjust the inventory records, record the transaction in the financial records, and file any claims.

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		4. Two copies are sent to the receiving agency. One is returned to KCCO as the receiving document, and the other is retained by the receiving agency. 5. The remaining two copies are also sent to the receiving agency but only if two or more orders are included in the same shipment; otherwise they are discarded.
	The two-part Shipping Notification is completed by the shipper to show such information as whether the product is being sent by rail or truck, when it will be shipped, the carrier, and destination. One copy is sent to notify the FNS data processing center in Minneapolis, Minnesota. The other copy is sent to notify the receiving agency. The shipper is also instructed to advise the receiving agency about the shipment by telephone.	

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Advance Comments From the Department of Education, State of Michigan

Note: State comments and GAO's evaluation thereof are on pages 39 and 40 of the report.

STATE OF MICHIGAN

DEPARTMENT OF EDUCATION

Lansing, Michigan 48909

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August 12, 1985

Mr. J. Dexter Peach, Director
Resources, Community, and
Economic Development Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed draft sections of your proposed report entitled Inventory Management Systems for Federally Owned and Donated Surplus Foods -- Improvements Needed at State and Local Levels and offer the following comments:

1. We concur with most of the findings as reported and believe the report presents a fair picture of the program operations as they existed in mid 1984.

2. We believe clarification is warranted, however, in regards to comments presented on pages 42 and 69:

Now on pages 39 and 62.

   a. The implementation of the inventory reporting system and the on-site reviews of local agency operations had only a coincidental relationship to the food loss in Detroit, i.e., the reporting system and the reviews would have been pursued regardless of the food loss.

      1. It is noteworthy that the claim issued against the City of Detroit was closed earlier this year with the verification of full replacement of the food loss. Local food and cash donations were acknowledged as replacement for the food loss.

      2. The reporting and monitoring practices of the State agency have become more specific and operative since the inception of the program. This is attributed in part to the manner in which the program has evolved. For perspective, the program began as a one-time cheese distribution in early 1982. Second and third distributions eventually became monthly distributions. During this time period there were relatively few program guidelines and emphases were on distributing foods to those who declared a need for food assistance.

         Federal funding for in state program operations initially became available in May 1983. The short term nature of the program continued to be promoted in 1983 as the May 1983 enabling legislation had an expiration date of September 30, 1983.

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With enactment of the TEFAP legislation in late summer of 1983 a greater emphasis was placed on operations structure and accountability. During the winter and spring of 1983-84 states and local organizations implemented a number of operational policies to strengthen eligiblity determination, product handling, and recordkeeping practices and procedures.

3. In conjunction with (2) above, it is noteworthy that TEFAP is not financially self-supporting. Rather, it is heavily dependent upon donations (donated space to conduct the distributions and volunteer time) and other resources. For illustration, volunteers account for nearly 80% of the labor hours of local agencies in Michigan. Even with these donations the TEFAP funds cover only about 60% of local agencies' TEFAP operation costs. The remaining costs are being borne by CSBG, local funds, or other available resources.

b. The 1984 on-site reviews focused on multiple aspects of the local agency operations. These include: (1) recipient eligibility determination practices and procedures; (2) product tracking practices and procedures employed to account for products received and distributed; (3) adequacy of storage facilities; (4) rates of issuance; and (5) recordkeeping.

I am hopeful these comments will be taken into account as the report is finalized. In the event you have questions on these matters, please contact me at (517) 373-3314.

Sincerely,

Philip J. O'Leary, Director
School Management Services

PJO:RK/pkb

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Advance Comments From the Department of Agriculture, Commonwealth of Pennsylvania

Note: GAO comments supplementing those within the report text appear at the end of this appendix.

Commonwealth of Pennsylvania

DEPARTMENT OF AGRICULTURE

OFFICE OF THE SECRETARY

August 22, 1985

J. Dexter Peach
Director
United States General Accounting Office
Washington, D.C. 20548

Dear Director Peach:

Thank you for the opportunity to review and comment on a section of your proposed report entitled Inventory Management Systems for Federally Owned and Donated Surplus Foods - Improvements Needed at State and Local Levels that pertains to our operation of the Temporary Emergency Food Assistance Program.

This audit was initially expanded from a GAO audit of eight states to include Pennsylvania at the request of Senator John Heinz. The scope of the audit was to include reviews of records of commodities received by Pennsylvania from the USDA, reimbursement procedures to local distributing agencies, and the impact of recent USDA eligibility guidelines based on household income.

However, the scope of this review changed dramatically from Senator Heinz's original request, and appears to have been focused on inventory control at the State level. Indeed, you have stated in your July 22, 1985 letter that this proposed report pertains to our Department's operation of the Temporary Emergency Food Assistance Program and yet, there are several references to and analysis made to our inventory program for our traditional school and institutional programs. We believe this to be most inappropriate in that it was never included in the scope of your audit, information was never requested on this program by your auditors, and absolutely no mention was ever made of the change in scope or any reference to this program at the exit conference.

See comment 1.

Senator Heinz initiated this review, saying "Congress passed this program to feed the hungry, but the surplus cheese and butter may not be getting to those needy individuals," and "Pennsylvania is in a difficult position, since the Federal government has given very little guidance on how to implement this temporary program of food assistance."

Reviews conducted by GAO are normally conducted by measuring compliance with existing regulations. However, USDA has not finalized regulations for implementing TEFAP. The auditors measured our performance

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in Pennsylvania against an "optimum system" that should have been in existence from the start of this program, even with their full recognition of the evolutionary history of the implementation of this program especially the absence of adequate funding. Many of the issues emphasized by the auditors appear to have been based on preconceived ideas implanted by individuals outside the system for political or personal reasons.

See comment 2.

The Pennsylvania Department of Agriculture was not afforded any written material, findings, comments or written recommendations to review prior to our exit conference on January 17, 1985. Less than two days before the "exit conference," we received an agenda of items to be discussed, and this was by telephone. Essentially, we were "afforded" the opportunity to comment only on generalities and suppositions, but were expected to respond with conclusive rebuttals of "facts!"

It is especially important to note that the United States Department of Agriculture Mid-Atlantic Regional Office had two representatives at our exit conference which lasted over five hours. They share many of our opinions on the issues and disenchantment with the attitude of the auditors and their conduct of the audit.

See comment 3.

The report as presented contains statements that are not directly applicable to current conditions. In many instances it appears that our management policy plans had no impact on the auditors findings and recommendations. The following comments will substantiate this position:

See comment 4.

Pennsylvania's inventory management system was inadequately implemented but improvements were being made:

Your statements are not time specific. In January 1985 the inventories for our seven warehouses were verified and out on our Monroe automated system. The headings are: (1) beginning balance, (2) receipts, (3) total, (4) allocations, (5) rejections, (6) adjustments, and (7) ending inventory. Our warehouses are required under our contract to submit monthly inventories on or before the 10th of the following month. This is verified against our inventory and any adjustments necessary are made prior to our next allocation of commodity. This system is also periodically checked by our field review staff.

See comment 5.

The bulk commodities are not involved with the TEFAP Program.

Perpetual inventories are a warehouse responsibility under our contract subject to frequent verification and at least one annual physical inventory.

FNS procedures regarding control of spoiled products which was discussed at the exit conference has been resolved. GAO provided the specific information and we addressed the issue and resolved it. See Attachment "A".

Under the TEFAP Program and our agreement with local governments, the accountability factors are part of our agreement.

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The utilization of the Bureau staff involved in TEFAP is documented through Time and Attendance Reports. The temporary nature of this program and our management policy to maximize the utilization of limited funds to the local level resulted in our management policy of part-time assignments of staff as opposed to the hiring of full-time support staff. Through this method of operation, we have been able to provide an unprecedented 94% of the Pennsylvania's fund authorization to local government at the local level thus permitting maximum fund utilization and are in compliance with the Congressional intent of this program.

Your auditors field work covered a period April 1984 through January 1985. In July of 1984, we competitively bid the TEFAP Program warehouse contracts which resulted in seven warehouses strategically located throughout the Commonwealth. Under our new automated system, staff employes are no longer required to be specifically assigned to a warehouse or storage facility.

See comment 6.

Pennsylvania had not properly accounted for products under state control:

Your statements again are not time specific and very general in nature. It is not possible to provide a specific response. For your information, our ordering system has been computerized for the 1985-86 year. The system will include sophisticated management information reporting to facilitate improved internal control and accountability.

The period September 1983 to January 1984 and the issue mentioned regarding [illegible] truckloads of cheese. According to our current record we ordered 318 truckloads of cheddar and processed cheese during the period in question. Three hundred loads were received and 18 loads were canceled by USDA. See Attachment "B" for information on those truckloads canceled.

In Pennsylvania all commodities allocated with delivery order (DO) numbers are accounted for. Sometimes however, conditions beyond the States' control result in truckloads being canceled and the commodity not being delivered.

The time requirements of this response has not permitted us to reconstruct the bulk cheddar cheese cutting operation to respond to your statement. Pennsylvania, however, did recover $32,005.66, representing the salvage value of trim (with no mold) as a result of the cutting operation.

See comment 5.

Processing of USDA commodities is not a part of the TEFAP Program.

You mention the sub-distributing agent function regarding inventory reports and etc. As mentioned previously, the operation has been automated and we no longer have a staff person at the warehouse or storage facility.

Pennsylvania had not notified FNS of spoiled products:

This issue has been resolved. Please refer to Attachments 1 and 2.

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Condition of Pennsylvania's warehouses generally satisfactory:

We are very pleased with the current inspection and review of the contracted for warehouse facilities.

The Department's Bureau of Foods and Chemistry as you have noted does inspect and license cold storage facilities in Pennsylvania. In addition, you should know that the Bureau of Foods and Chemistry does a quarterly inspection after a facility is licensed. These reports are shared with the Bureau of Government Donated Food.

In addition, the Bureau of Government Donated Food does a monthly review of each facility which includes an inventory spot check of two different commodity items. Our field person also follows up on any Foods and Chemistry recommendations.

We also do a physical inventory every six months at the seven warehouses we currently contract with for the storage of TEFAP.

Pennsylvania needs to improve its management of local agencies:

The program deals with local county governments who manage the TEFAP Program or choose to contract with a lead agency to manage the program for the county. The county or lead agency in turn contracts with what we refer to as recipient agencies who actually distribute the commodity to eligible recipients under the program. The agreement/contractual relationship includes accountability for record keeping and inventory at the local level with review by cognizant Federal and state agencies.

It is our opinion that the existing internal controls are acceptable at the local level commensurate with a "temporary" program with limited resources. The report did not mention the substantial volunteer effort involved with our program in Pennsylvania. It is the only program we know of that relies so heavily on volunteer assistance and we have never failed to credit this contribution as being the basis for our program's success.

Volunteer assistance is not without challenges however, especially in organizational continuity and maintenance of effort.

FNS regional offices need to review state inventory reports to monitor inventory levels:

We are of the opinion this is being accomplished.

State monitoring of local agencies now required:

Beginning with 1985, Pennsylvania did establish a monitoring and review system for TEFAP. This was about the same time FNS also moved into this area. Our field representatives role is expanded to include the TEFAP Program and warehouse review responsibilities.

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We are assuming, unless otherwise advised, that your change in the scope of your original review is still focusing on the TEFAP Program and that with the Pennsylvania program those areas originally addressed are considered satisfied with the exception of inventory management.

We are disappointed that the benefits of our new system implemented in March of 1984 were not addressed in the report as prominently as we had hoped. Pennsylvania's TEFAP Program has improved dramatically over the past 20 months, and in fact, is often used by the U. S. Department of Agriculture as a model for other states.

We are proud of the fact that more than 148 million pounds of commodities worth in excess of $173 million have been distributed to needy Pennsylvanians since the inception of this program, ranking the State third in the nation in total pounds distributed and first in pounds per capita.

Thank you again for the opportunity to review and comment on this section of your proposed report. Please know that we are readily available for any further clarification or additional information that you may need.

Sincerely,

RICHARD E. GRUBB
Acting Secretary

See comment 7.

Attachments

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The following are GAO's supplemental comments on the Commonwealth of Pennsylvania's Department of Agriculture's letter dated August 22, 1985.

GAO Comments

1. As the state's comment indicates, our initial work was to include several of the concerns raised by the requestors, such as those listed by the state. We reviewed those concerns and reported the results through oral briefings and, in one case, a separate report. As a result of the briefings, we reached agreement with the requestors (including Senator Heinz) that the remainder of our work would focus on determining whether USDA's and the states' inventory management systems assured that the surplus products owned by USDA and donated to the states were properly controlled and efficiently managed. (See pp. 12 and 13.)

Regarding the Department's comment that we reviewed the inventory systems for programs other than TEFAP, the report included a summary of OIG's findings on its review of controls over products used in other programs, including the systems to control bulk products sent to commercial firms for processing (see p. 42) and products stored in state warehouses (see pp. 43-45). Because the state's procedures for controlling such products were generally the same as those used to control TEFAP products, we believe that our discussion of the OIG's findings is appropriate. The report also discusses the state's inventory level for all programs because, as discussed on page 60, the state did not segregate inventory data by program.

2. Under FNS regulations applicable to all food donation programs, including TEFAP, states have prime responsibility for assuring that products are adequately controlled. Nevertheless, the major problems we found with Pennsylvania's inventory system dealt more with its implementation than with its design; hence, we did not measure the state's performance against an optimum system but rather against the state's own system.

3. When our work at an organization is completed and before we prepare a draft report, we hold an exit conference with appropriate officials to (1) present our review results, including potential solutions to any identified problems, and (2) give the organization's officials an opportunity to give us their views on our work and to provide us with any additional information they believe we should consider. We do this to obtain a clear and complete understanding of the issues discussed, to

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decide on their further use in the assignment, and to establish an Office position on them.

At times we may provide a written agenda, work summary, or statement of facts to knowledgeable officials before the conference, but this is not always done. In the Pennsylvania case, we advised state officials of the agenda by telephone before we held the exit conference but did not provide any written material at that time. We did, however, provide state officials with written material on selected matters following the conference and, in keeping with our general policy, provided them with pertinent sections of a written draft of this report for their formal comments.

4. Although our report contains information on the state's actions to improve its inventory management system, our review results are based on our detailed review of the system in place at the time of our fieldwork. Nevertheless, we believe that the state's actions should, if properly implemented, improve the inventory control practices at both the state and local levels.

5. The only bulk commodity we reviewed is the 3.8 million pounds of bulk cheddar cheese processed into ready-to-use form that was not properly accounted for. (See p. 42.) Information we have shows that the bulk cheese was designated for use under TEFAP. For example, the Director of the Department's Bureau of Government Donated Food identified the 3.8 million pounds of cheese as a TEFAP product in an April 3, 1984, letter to the FNS regional office. For the reason discussed in comment 1 above, however, we did present OIG's findings on the processing of other bulk commodities.

6. We reviewed the state's inventory management system in place at the time of our fieldwork, which was essentially completed in October 1984. Regarding the Department's comment that the warehouse contracts were competitively bid in July 1984, the program director told us on July 26, 1984, that the new warehouse inventory system was not expected to be fully implemented until January 1985.

7. Although Pennsylvania's attachments are not included in this report, pertinent information contained therein on spoiled products and control over product orders and receipts is included in the final report.

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Advance Comments From the Department of Education, State of California

Note: State comments and GAO's evaluation thereof are on page 53 of the report.

CALIFORNIA STATE DEPARTMENT OF EDUCATION — **Bill Honig**
721 Capitol Mall — Superintendent
Sacramento, CA 95814 — of Public Instruction

August 14, 1985

J. Dexter Peach, Director
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Peach:

Mr. Honig has requested that I forward to you our comments on those portions of your audit of the Temporary Emergency Food Assistance Program (TEFAP) which pertain to California.

We have moved forward to strengthen state and local management in accordance with USDA regulations. We believe that the actions taken by our staff will result in correcting the problems identified in your report.

If you have questions regarding our responses, please call Mr. Steve Delano, Acting Administrator, Office of Food Distribution, (916) 445-4943.

Sincerely,

Robert W. Lawrence
Deputy Superintendent
for Field Services

cc: Maria Balakshin, Director
Child Nutrition and Food Distribution
Division

Carolyn Pirillo

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State Department of Education
Office of Food Distribution

August 14, 1985

California's Response to U. S. General Accounting Office
Draft Report Entitled

Inventory Management Systems for Federally Owned and Donated Surplus Foods--Improvements Needed at State and Local Levels

1. GAO FINDINGS

> "At the FNS Western Regional Office, we learned that the state agency, primarily for staffing reasons, did not summarize and include TEFAP data on the monthly inventory reports (FNS-155) submitted to the region on FNS distribution programs."

OFFICE OF FOOD DISTRIBUTION (OFD) RESPONSE

OFD has included TEFAP data on the monthly inventory report (FNS-155) since September 30, 1984 per verbal instructions from USDA.

2. GAO FINDINGS

> "Our review of the state agency's files showed that, as of November 2, 1984, the state had received signed bills of lading for only 64 (22 percent) of the 293 delivery orders submitted to FNS during the last quarter of fiscal year 1984. State Agency officials told us that the agency would follow up with the local agencies to obtain the required documentation after the new staff were hired."

OFD RESPONSE

OFD records indicate that there were 520 delivery orders issued in the TEFAP program for the period of July 1 through September 30, 1984. A total of 412 delivery order receipts have been confirmed with local agencies. OFD has made two separate requests to food banks for the delinquent receipts. The first request was made on December 7, 1984 and the second was made on April 11, 1985. A third request is being prepared at the present time. The third request will be followed with field work to obtain the delinquent receipts.

3. GAO FINDINGS

> "According to the State's fiscal year 1985 operating plan, state agency personnel would evaluate each local agency's program at least once every 6 months. The plan states that the evaluations will include a review of each agency's inventory records to ensure that all transactions are properly recorded."

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OFD RESPONSE

OFD received authorization to hire the staff necessary to implement the USDA approved 1984-85 state plan. State field staff have been trained on TEFAP regulations; presenting workshops for food bank management personnel and sub-distribution site staff; and initiated the first comprehensive review of each food bank's operation. The field staff have completed the reviews of nearly all of the food banks and are writing reports on their findings. These field reviews have included an evaluation of the adequacy of each agency's inventory records. Where deficiencies have been observed, requests with instructions are being forwarded to the food banks to develop corrective action plans.

OFD has completed and distributed to all food banks and to their distribution sites the administrative manual designed to assist the food banks to properly administer the TEFAP program. Included in the administrative manual are instructions on how to set up, maintain, and operate record keeping systems. OFD has noticed a significant improvement in record keeping since the presentation of the workshops and the issuance of the manuals.

4. GAO FINDINGS

> "Although California required periodic inventory reports from local agencies, the reports were not being reviewed by state personnel."

OFD RESPONSE

OFD's visits to local food banks during 1983-84 were for the purpose of providing overall guidance and technical assistance. These visits were made prior to the establishment of the general requirement for monitoring activities referenced in the report.

As noted heretofore, OFD is making field reviews of the food banks and many of their distribution sites. Reports are being prepared evaluating the effectiveness of the food banks' management of the TEFAP program. Food banks are being asked to submit corrective action plans where deficiencies have been noted.

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Advance Comments From the Office of General Services, State of New York

Note: State comments and GAO's evaluation thereof are on page 56 of the report.

MARIO M. CUOMO
GOVERNOR

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
OFFICE OF GENERAL SERVICES
MAYOR ERASTUS CORNING 2ND TOWER
THE GOVERNOR NELSON A. ROCKEFELLER EMPIRE STATE PLAZA
ALBANY, N.Y. 12242

JOHN C. EGAN
COMMISSIONER

August 12, 1985

Mr. J. Dexter Peach
Director
United States General Accounting Office
Resources, Community and Economic
Development Division
Washington, D.C. 20548

Dear Mr. Peach:

Thank you for your July 22, 1985 letter enclosing appropriate excerpts from your proposed report titled Inventory Management Systems for Federally Owned and Donated Surplus Foods - Improvements Needed at State and Local Levels. I was pleased to note the conclusion reached by your representatives, during their review some ten months ago, regarding the adequacy of accountability for Temporary Emergency Food Assistance Program (TEFAP) products under New York State control. Since the material presented on State control requires no further clarification, the following comments will be directed toward local accountability for TEFAP products.

Throughout the two-year life of the current program, the United States Department of Agriculture (USDA) has not provided either written or oral directions regarding the specific types of records which must be maintained at the local distributing level. In the absence of specific directions, the Office of General Services, Bureau of Government Donated Foods, has informed all organizations of the general requirement that records connected with the distribution of donated foods must be created and retained as evidence of distribution activities. Every distribution site in the State has been visited by the Bureau's field staff, and each site has been provided guidance on record keeping requirements. As a minimum, all organizations must keep a copy of the pick up slip, which shows the amount of each product received by the organizations from the State for each distribution, and some form of log listing the names of the recipients of food during each distribution. During the follow up reviews of each distribution site, field personnel have required all organizations to demonstrate the means by which information was recorded on the distribution of each product, have reviewed records maintained by the organizations, and have taken remedial action where necessary.

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Mr. J. Dexter Peach -2- August 12, 1935

Since the inception of TEFAP in late 1983, more than 100 million pounds of donated foods have been distributed to those in need in New York through mostly volunteer organizations which use both time and effort contributed by concerned citizens. In our administration and overall coordination of the program, this agency has attempted to ensure that administrative regulations and monitoring procedures are adequate to establish accountability, but do nothing to detract from the primary purpose of getting TEFAP products to the needy in a timely, effective manner. To that end, the burden of accountability has been assumed primarily by the State and this agency, and the requirements placed upon local organizations have been minimized. I am confident that our approach has been successful, and New York's record of massive distributions with practically no product loss would appear to support my confidence.

In the event that TEFAP is extended beyond September 30, 1985, my staff will continue to work directly with the hundreds of local distributing organizations in New York on the creation and maintenance of adequate records which ensure accountability. Both the USDA and the General Accounting Office can be assured of our continued commitment to proper program operation and full cooperation in monitoring the distribution of each pound of food to the best of our ability, within the limits of available resources.

It would be greatly appreciated if you would forward to my office a copy of your final report upon completion, as my staff and I are most anxious to review the assessment of accountability in its entirety. In the interim, please do not hesitate to contact me if we can be of further assistance in this matter.

Sincerely,

John C. Egan

John C. Egan

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Advance Comments From the Food and Nutrition Service, U.S. Department of Agriculture

United States Department of Agriculture

Food and Nutrition Service

3101 Park Center Drive
Alexandria, VA 22302

Mr. J. Dexter Peach
Director
Resources, Community, and
Economic Development Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed your draft GAO report dated July 22, 1985 entitled "Inventory Management Systems for Federally Owned and Donated Surplus Foods--Improvements Needed at State and Local Levels." Attached are our responses to the issues in the draft report.

If we may be of further assistance please let us know.

ROBERT E. LEARD
Administrator

Attachment

GAO DRAFT OF A PROPOSED REPORT DATED JULY 22, 1985
ENTITLED "INVENTORY MANAGEMENT SYSTEMS FOR FEDERALLY OWNED AND DONATED SURPLUS FOODS - IMPROVEMENTS NEEDED AT STATE AND LOCAL LEVELS"

General Comments

In general, the Department agrees with the recommendations contained in the draft report. The Department's Food and Nutrition Service (FNS) has developed and published proposed regulations that strengthen the standards for monitoring, reporting, and recordkeeping. These actions will indeed strengthen program controls to minimize abuse of the program.

While FNS and GAO have reached the same basic conclusions, FNS believes that the draft report incorrectly fails to acknowledge the developmental nature of this program. At its commencement in December 1981, there was no existing Governmental infrastructure to accomplish distribution of commodities to households. Accordingly, the program was designed to give maximum latitude to States in identifying organizations willing to assist in this special effort. The organizations that responded were mostly volunteer groups that understandably lacked the capability and resources to absorb major administrative requirements. In order to implement the special dairy program as quickly as possible, the States were given the responsibility of locating the appropriate distribution outlets and administering their own special distribution program.

Based on the amounts of dairy products available and the program's popular support, the program was extended from 1982 until September 1985. However, it has consistently been viewed as a temporary emergency program. As such, FNS has been reluctant to encumber the program with elaborate rules, regulations and requirements. Because the program was extended and administrative funds were made available to States and local distribution outlets, the temporary, and predominantly volunteer nature, of the program has gradually changed. Since GAO's review and because commodities are likely to remain available for distribution, FNS has developed regulations that will establish specific monitoring, reporting, and recordkeeping requirements which will strengthen program accountability.

GAO Recommendation

We recommend that if TEFAP is extended or replaced with a similar program, the Secretary of Agriculture direct the FNS Administrator to require the FNS regional offices to

--periodically evaluate and report on States' inventory management systems to provide management with the information needed to determine whether the systems provide control over the receipt, disposal,

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and inventory of products at both the State and local levels and...

Response

If TEFAP is extended past September 1985, we will be working to strengthen the standards for monitoring, reporting, and recordkeeping which will improve program accountability. The regulations will establish specific standards for States to use in monitoring program performance as well as specific recordkeeping and reporting requirements at the State and local levels. The monitoring component will include methods by which the States and in turn, the Department, have of assessing operational aspects of TEFAP. Feedback for monitoring activities will provide valuable information about the need for technical assistance at both the State and local levels. We will continue to use volunteers and will be careful that recordkeeping, monitoring, and reporting requirements are followed. However, we have also been mindful of the legislative requirements to minimize paperwork for State and local program cooperators.

GAO
Recommendation

We recommend that if TEFAP is extended or replaced with a similar program, the Secretary of Agriculture direct the FNS Administrator to require the FNS regional offices to

--review the monthly inventory reports submitted to them by the States to ensure that data on TEFAP are reported and that inventory levels are related to normal usage.

Reponse

As mentioned above, we will strengthen the rule for monitoring, recordkeeping, and reporting which will improve program controls to minimize potential abuse of the program. FNS will monitor reports we require of the States.

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